BNY MELLON
INVESTMENT MANAGEMENT

August 16, 2021

Submitted via fsb@fsb.org

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

BNY Mellon Investment Management welcomes the opportunity to respond to this Consultation Report on policy proposals to enhance money market fund ("MMF") resilience.[1] BNY Mellon Investment Management is one of the world's leading investment management organizations and one of the top U.S. wealth managers, encompassing BNY Mellon's affiliated investment management firms, wealth management services and global distribution companies.

Our input reflects perspectives from an asset management lens, in particular BNY Mellon Investment Adviser, Inc., ("BNYM Investment Adviser") which is registered with the U.S. Securities and Exchange Commission (the "Commission") as an investment adviser under the Investment Advisers Act of 1940. As of July 31, 2021, BNYM Investment Adviser managed 119 domestic investment company portfolios with approximately $324 billion in assets, for approximately 211 thousand investor accounts nationwide. As of the same date, BNYM Investment Adviser managed approximately $234.4 billion invested in 17 domestic money market mutual funds structured within the confines of Rule 2a-7 under the Investment Company Act of 1940.

Introduction

The 2008 financial crisis and the 2020 financial crisis had similar market impacts, including investor runs on institutional prime money market funds and a freezing of the short-term credit market. But these two crises diverge in a key respect – their causes.

The 2008 financial crisis was caused by several factors, including failed counterparty credit risk.[2]

The 2020 financial crisis was triggered by a global pandemic, which amplified vulnerabilities in the short-term funding markets. Economic uncertainty triggered an investor "dash for cash", which put liquidity pressure on the market.[3] Money market funds did not cause the market stress that the industry experienced in March 2020 but were adversely impacted by it. In fact, no fund actually "broke the buck" in 2020 (unlike 2008), and there were no credit issues in 2020. The

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

[2] FSB Consultation Report, p. 18.

[3] FSB Consultation Report, p. 18.

liquidity-related concerns for the funds themselves in 2020 were exacerbated by the minimum 30% weekly liquid asset (WLA) link to the fees and gates threshold. This link created a "bright-line" effect which resulted in certain investors withdrawing balances out of prime funds as their WLA got closer to the 30% number.

Whilst the nature of the crisis was different, we support the efforts underway to review such vulnerabilities and to further enhance the resiliency of money market funds to meet investor expectations and redemptions in various market conditions.

BNY Mellon supports the following overarching goals for money market fund reform:

- Effectively address the structural vulnerabilities in money market funds that have been impacted by stress in short-term funding markets,
- Improve the resilience and functioning of short-term funding markets, and
- Reduce the likelihood that interventions and taxpayer support would be needed to prevent future money market fund runs or address stresses in short-term funding markets.

Recommendations

Due to the breadth of suggestions offered in the FSB Consultation, we are focusing on the recommendations that we believe would have the greatest potential to support the continued smooth functioning of the money market fund industry in various jurisdictions and market environments:

1. Decouple link between regulatory liquidity thresholds and imposition of fees and gates
2. Enhance liquidity requirements, such as limits on eligible assets

These reforms should be aimed at prime MMFs rather than public debt MMFs, which did not suffer the same liquidity outflows that were witnessed in other parts of the market.[4]

1. Decouple link between regulatory liquidity thresholds and imposition of fees and gates

For certain MMFs, the fund's board can impose redemption fees and gates once regulatory liquidity thresholds are breached. In the United States, for example, prime MMFs have a 30% Weekly Liquid Asset ("WLA") Portfolio Minimum and a 30% WLA Governance Threshold at which point the fund's Board may impose fees and gates. This 30% linkage can cause destabilizing redemptions as investors pre-emptively redeem to avoid fees and gates, even where the fund has sufficient liquidity. These redemptions, in turn, drive the liquidity buffer lower and cause fund managers to sell assets to maintain the liquidity buffer. This cycle impairs a fund's ability to use liquidity buffers to meet redemptions.

[4] FSB Consultation Report, pp. 18-19.

We agree with the recommendation to decouple regulatory liquidity thresholds from the imposition of fees and gates. This option would reduce the incentive for pre-emptive runs and also encourage the use of liquidity buffers to meet redemptions as intended during times of stress.

One way to de-couple the two while maintaining sufficient liquidity and certainty for investors is to reduce the threshold for imposition of fees and gates. In the United States, for example, this could mean reducing the WLA Governance Threshold from 30% to 15% to avoid pre-emptive redemptions as a fund reaches 30%.

If these rules were indeed removed it would be important to ensure that rating agencies methodologies are also modified accordingly. It will be important to ensure that rating agency limits do not become a driving factor of behaviour in stressed conditions.

2. Additional liquidity requirements and limits on eligible assets

Enhancing liquidity requirements to reduce liquidity transformation also may have merit depending on how they are implemented. Any such proposal must be:

- Data driven;
- Consider the types of assets readily available in various jurisdictions;
- Not be so restrictive as to materially impact money market funds' ability to serve as direct sources of financing for businesses and financial institutions;
- Not be so restrictive as to make it difficult to continue to attract investors by providing a return that is above that of a public debt money market fund (*e.g.*, US Treasury or government money market fund); and
- Be aligned with a decoupling from the governance threshold to avoid unintentionally increasing the risk of pre-emptive redemptions from watchful investors.

In the United States, for example, one solution may be a 10% minimum investment in US Treasury securities for prime money market funds. This solution is feasible in the United States given the deep and liquid US Treasury market, ability to diversify the remainder of the portfolio, and potential to maintain performance over government funds. However, we note that this solution may not be feasible in other jurisdictions.

3. Views on other FSB Policy Proposals

Other recommendations, such as the move from constant net asset value ("NAV)" to floating NAV, swing pricing, minimum balance at risk, and capital buffer would fundamentally change the nature and attractiveness of the underlying MMF relative to other types of investment funds (*e.g.*, short-term bond funds) or cash and cash substitutes (*e.g.*, bank deposits, government funds where available in the US and UK).

We would note that swing pricing would have a particularly detrimental impact.

- Implementing swing pricing would cause funds to go to a T+1 redemption model, at a minimum. As same day liquidity is a mandatory feature for a large segment of MMF investors, taking it away would invariably have a large negative impact on fund assets.
- Swing pricing also risks exacerbating pre-emptive runs as investors will look to redeem positions prior to the implementation of any pricing haircuts. This is the same behaviour witnessed in Q1 2020 as investors redeemed to avoid the potential of fee and gating provisions.
- Implementing swing pricing functionality on either intermediary or direct asset manager platforms would be operationally difficult and costly, leading to narrower distribution of these products.

We expect reforms that materially change the attractiveness of prime money market funds will push assets into stable NAV government only funds and less regulated products such as separately managed accounts and private liquidity pools.

Conclusion

We appreciate the FSB's efforts in proposing different mechanisms for enhancing the resilience of the money market fund industry. While each proposal presents an opportunity to enhance the resilience of the market and reduce the likelihood of government interventions and taxpayer support, we believe that decoupling regulatory liquidity minimum from the imposition of fees and gates presents the greatest opportunity to enhance the resilience of MMFs, reduce the likelihood of government interventions and taxpayer support, and preserve the attractiveness of non-public debt MMFs. In addition, enhanced liquidity requirements, such as limits on eligible assets, would reduce liquidity transformation depending on the MMF jurisdiction and market.

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We thank the FSB for the opportunity to present our views on the issues raised in the consultation report. We welcome the chance to speak further if you have questions or would like to open an active dialogue.

Sincerely,

Hanneke Smits

CEO of BNY Mellon Investment Management