August 16, 2021

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel SWITZERLAND

By electronic submission: fsb@fsb.org

RE: Policy Proposals to Enhance Money Market Fund Resilience – Consultation report

Dear Sirs:

Charles Schwab & Co, Inc.[1] ("CS&Co") and Schwab Asset Management[2] (collectively with CS&Co, "Schwab") appreciate the opportunity to provide comments to the Financial Stability Board (the "FSB") on its June 2021 consultation report, "Policy Proposals to Enhance Money Market Fund Resilience."

Schwab is one of the largest managers of money market fund assets in the United States, with 12 money market funds and $152 billion in assets under management as of June 30, 2021. Approximately $83 billion of those assets are in two prime funds (including a retail fund and an institutional fund with a floating net asset value); $14 billion are in four tax-exempt municipal money market funds; and $52 billion are in five government money market funds. Schwab also manages an Irish-domiciled public debt fund with $3 billion in assets under management. Money market funds provide investors with stability, convenience, liquidity and yield. Schwab's money market fund offerings predominantly appeal to, and are used by, individual retail investors and investment advisers who service individual investors to help manage their cash.

Overview

Schwab has been an active participant in the debate over money market fund regulation for well over a decade. We were supportive of the U.S. Securities and Exchange Commission's 2010 reforms to Rule 2a-7, which strengthened money market funds by increasing transparency and

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[1] The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services, with 32.3 million active brokerage accounts, 2.1 million corporate retirement plan participants, 1.6 million banking accounts, and $7.57 trillion in client assets as of June 30, 2021. Through its operating subsidiaries, the company provides a full range of wealth management, securities brokerage, banking, asset management, custody, and financial advisory services to individual investors and independent investment advisors. Its broker-dealer subsidiaries, CS&Co, TD Ameritrade, Inc., and TD Ameritrade Clearing, Inc., (members SIPC, https://www.sipc.org), and their affiliates offer a complete range of investment services and products including an extensive selection of mutual funds; financial planning and investment advice; retirement plan and equity compensation plan services; referrals to independent, fee-based investment advisors; and custodial, operational and trading support for independent, fee-based investment advisors through Schwab Advisor Services. Its primary banking subsidiary, Charles Schwab Bank, SSB (member FDIC and an Equal Housing Lender), provides banking and lending services and products. More information is available at https://www.aboutschwab.com.

[2] As June 30, 2021, Schwab Asset Management managed approximately $596 billion on a discretionary basis and approximately $40.1 billion on a non-discretionary basis. Schwab Asset Management is the dba name for Charles Schwab Investment Management, Inc. Schwab Asset Management provides non-discretionary advisory services to the Schwab Trust Bank Collective Investment Trusts, including research and recommendations relating to asset allocation, portfolio construction, cash-flow monitoring and advisor selection and retention. Some trusts include multiple unit classes. More information is available at www.schwabassetmanagement.com.

reducing the risk of runs.[3] In 2012, an op-ed piece[4] in *The Wall Street Journal* by Schwab CEO Walter Bettinger proposed that prime money market funds for institutional investors be required to have a floating net asset value ("NAV"). A version of this proposal was ultimately adopted by the Commission in 2014.[5] Schwab believes that the 2010 and 2014 reforms to Rule 2a-7 enhanced the stability of money funds and the funds' ability to continue to function in illiquid markets. However, with the benefit of our experiences in the March 2020 market volatility that contributed to stresses in the short-term funding markets, we believe additional reforms could further strengthen the resiliency of money funds, particularly in more volatile markets.

In its consultation paper, the FSB seeks responses to a variety of proposals to strengthen money market funds. The paper notes that a key question for strengthening the regulatory framework for money market funds is "whether the goal of enhancing resilience is to be achieved by making them more cash-like (i.e., aiming at preservation of capital and liquidity for investors) or more investment-like (i.e., allowing greater price variability or changes in redemption terms in stress)."[6] Schwab recommends that regulators take the latter approach, with the goal of making it more clear to investors of all types that money market funds are an investment product that has risks. In an era of extraordinary transparency for investors, the constant NAV for prime and municipal money market funds has become an anachronism. It may suggest to investors that the value of assets in all money market funds is the same – $1 per share – and that it does not fluctuate or have associated risk. Of course, the value of a share of a money market fund does fluctuate, albeit within a very small range, typically hundredths of a penny. But tiny fluctuations are still fluctuations. The current structure of money market funds, combined with a history of intervention by central banks, may create an expectation that assets in a money market fund are guaranteed to always remain $1 per share – an expectation that simply is not accurate. This misalignment makes prime and municipal funds more susceptible to runs in periods of market volatility, exacerbates stress in the short-term funding markets, and increases the likelihood that government institutions and taxpayer dollars will again be needed to reduce future potential stresses.

To that end, Schwab strongly supports three of the FSB's proposals, which we believe should be implemented in combination: 1) Requiring all non-governmental money market funds to have a floating net asset value; 2) Removal of the ties between regulatory thresholds and the imposition of fees and gates; and 3) Implementing policy reforms that strengthen the underlying short-term funding markets.

Floating NAVs for all Prime and Municipal MMFs

The primary benefit of requiring all prime and municipal money market funds to operate with a floating NAV is that it eliminates any chance of a fund's "breaking the buck" by seeing its share price drop below $0.995, the threshold below which an MMF can no longer continue rounding its price to the stable $1 per share. Two key features of money market funds that attract investors

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[3] See comment letter from Koji Felton, senior vice president, Charles Schwab Investment Management, September 4, 2009, available at: https://www.sec.gov/comments/s7-11-09/s71109-61.pdf.
[4] Bettinger, Walt, "Time for Compromise on Money-Fund Reform." *The Wall Street Journal*, November 23, 2012.
[5] *Money Market Fund Reform; Amendments to Form PF* (File No. S7-03-13), adopted July 23, 2014. 79 Fed. Reg., at 47736.
[6] Financial Stability Board consultation report, "Policy Proposals to Enhance Money Market Fund Resilience," June 30, 2021, at 5.

are price stability and liquidity. But the structure of money market funds in the United States creates a situation in which a fund could break the buck, leaving investors unable to redeem shares at full value. That dynamic creates the potential for a first-mover advantage, whereby early redeemers are likely to get full value for their shares, while losses are concentrated among later redeemers and non-redeemers. Later redeemers could also find that liquidity fees and/or redemption gates have been imposed, reducing their opportunity to redeem their shares at the full price or fully redeem their investments. With a floating NAV, fund sponsors simply redeem each investor's shares at the market price at the time of each investor's redemption. A floating NAV does not remove the first-mover advantage, in that early redeemers are likely to get a better price than late redeemers in a falling market, but this is no different than other types of floating NAV mutual funds and thus familiar to investors.

The December 2020 report of U.S. President's Working Group on Financial Markets (the "PWG Report") notes that "some retail prime MMFs experienced declining market-based prices in March [2020], but none of these funds reported a market-based price below $0.9975."[7] The report goes on to say that "some retail tax-exempt MMFs also had declining market-based prices. Although none of these funds broke the buck, one fund reported a market-based price below $0.9975."[8] Interestingly, the report notes that there appeared to be no correlation, in either retail prime MMFs or in retail tax-exempt MMFs, between outflows and a decline in market-based prices. This suggests that retail investors are not focused on the market-based prices of their money market fund holdings, or, to the degree that they were aware, they were unconcerned, given the relatively modest fluctuations compared to other assets. For some, it raises concern that despite the disclosure, education and detailed NAV data made available by asset managers, some investors may not have been aware of the risk to their investment had the market-based price of their shares continued to decline. Advocates of money market fund reform often use this kind of evidence to suggest that retail investors believe that their assets in any type of money market fund are guaranteed to remain $1 per share, regardless of market circumstances.

We originally advocated for a separation of prime fund investors into institutional and retail categories, and while this change has helped, over time it has not proven to wholly insulate retail investors from the actions of institutional investors. Institutional investors diligently monitor the markets throughout any given trading day. Consequently, in volatile market conditions, such as those that occurred in March 2020, institutional investors are more able to move quickly to reduce risk. In contrast, most retail money market fund investors do not track their prime and municipal money fund investments with the same degree of diligence and may not be aware in real-time of price movements in these funds. But while retail investors may not track real-time fluctuations, this last crisis demonstrated, as was the case in 2008, that retail investors tend to follow institutional investors' lead, even when they are not co-mingled in the same investment vehicle. That behavior accentuates the impact on retail investors because institutional funds hold the same security types and trade in the same markets. When retail money funds experienced redemptions in March 2020, they were selling assets into a market that was already struggling to

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[7] President's Working Group on Financial Markets, *Overview of Recent Events and Potential Reform Options for Money Market Funds.* 86 Fed. Reg. (February 10, 2021), at 8945.
[8] *Id*., at 8945.

absorb large amounts of the same securities being sold by institutional money fund investors.[9] As such, notwithstanding that retail investors were redeeming out of money market funds at a slower rate and on a delayed basis, the retail money market funds were nonetheless adversely impacted by the behavior of institutional investors. It underscores the idea that segregating institutional and retail investors into separate funds, as the 2014 reforms did, proved not to be wholly sufficient to shield retail investors from the behavior of institutional investors.

Schwab recommends that U.S. government money market funds be permitted to remain as constant NAV funds. This limited exception is warranted because government money market funds are required to invest almost entirely in government-backed securities and Treasury bills, which are backed by the full faith and credit of the United States. They do not raise the same credit issues faced by prime and municipal funds, and it is clear from investor behavior in March 2020 that both institutional and retail investors continue to have strong faith in these funds as a place of safety. Such funds have not historically needed to rely on the Federal Reserve support programs that were put in place in 2008 and 2020. We believe they should remain an option for investors.

We acknowledge that significant retail investor education will have to take place before any transition from a constant NAV to a floating NAV for retail prime and municipal money market funds. The industry will need to spend time and effort to educate investors that floating NAV funds can and should remain a core element of an investor's cash-management strategy, but that, like all investments, returns are not guaranteed. A lengthy transition period is likely to be necessary to ensure investors understand the changes. Regulators will also need to resolve whether floating NAV funds should continue to be permitted to call themselves "money market funds," as well as whether floating NAV money market funds should continue to be governed in the United States by Rule 2a-7. While we acknowledge that there may be bumps for the short-term financing markets during the transition period, we are confident that those markets will have improved resiliency and functioning as a result.

Requiring retail prime and municipal funds to have a floating NAV may also reduce the likelihood that official sector interventions and taxpayer support will be needed to halt future MMF runs. Similar to other types of floating NAV mutual funds, there would be no expectation by investors of government support or intervention. A floating NAV, however, is not a panacea, as can be seen from the fact that redemptions in March 2020 were larger and faster in institutional prime money market funds, which already have a floating NAV, than in constant NAV funds. What such a change will do is remind investors that the price of a share is not guaranteed to remain stable.

We also acknowledge that this change could have wider implications for the financial system, particularly the banking sector, which could see significant inflows from investors seeking a stable return and the guarantee against losses provided by federal deposit insurance. Those inflows have a variety of implications for banks, including, potentially, the need for banks to increase capital in order to meet federal capital buffer requirements.

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[9] Indeed, the PWG's own research suggests that retail investor outflows from prime money market funds in March 2020 were both smaller than outflows from institutional prime funds and delayed: "The redemptions from retail prime MMFs in March began a couple days after those for institutional funds." *Id*., at 8945.

Removal of the Thresholds for Removing Fees and Gates

Schwab also strongly endorses the removal of the tie between money market funds liquidity and the thresholds created in the 2014 U.S. reforms for the imposition of fees and gates. In particular, it has become clear that investors see the requirement that a fund must hold at least 30 percent of its total assets in Weekly Liquid Assets (or "WLAs") as a "bright line" for fund boards' imposition of liquidity fees and/or redemption gates rather than allowing WLAs to serve the need for which it was originally intended: to meet investor redemptions without imposing additional strains on the funds. As the FSB notes, "Regulatory thresholds may cause investors to pre-emptively redeem to avoid the consequences of a fund crossing those thresholds."[10] We saw an example of this taking place in March 2020. The PWG Report states, "preliminary research indicates that prime fund outflows accelerated as WLAs declined, suggesting that the potential imposition of a fee or gate when a fund's WLA drops below 30 percent encouraged institutional investors to redeem before that threshold was crossed."[11] Indeed, as the March 2020 crisis began to unfold, portfolio managers at Schwab increased WLAs to avoid even approaching the 30 percent threshold, knowing that even getting close to the threshold would increase investor anxiety and potentially spark redemptions. As a result, weekly liquid assets were well above the threshold throughout the crisis.[12]

The 30 percent threshold was intended to act as a cushion, ensuring enough liquidity capacity during times of market stress. But in reality, the requirement acts as a cliff, with funds unable to access that liquidity without sparking a potential run on the fund. That forces funds to increase WLAs well above the 30 percent threshold in order to create that cushion, an action that can contribute to broader market illiquidity. This was the case in March 2020, when most money market funds were seeking liquidity at the same time, exacerbating the market stress. Removing those thresholds should permit funds more flexibility for accessing additional liquidity in times of stress. Schwab believes that fund boards should have the option of imposing fees and/or gates when it is in the best interest of the fund and its investors, not when the weekly liquid assets level reaches the 30 percent or some other arbitrary threshold. Regardless of whatever other reforms regulators propose, we believe this change to be critical to the efficient operation of money market funds in the future. We agree with the comments of the Investment Company Institute, the Securities Industry and Financial Markets Association and other industry participants on this issue.[13]

Concerns about Swing Pricing Proposal

Schwab believes that requiring non-government MMFs to have a floating NAV obviates the need for one of the FSB's other reform proposals: swing pricing. Swing pricing is a mechanism that allows a fund's manager to lower the fund's NAV in times of heavy redemptions, thereby ensuring that transaction costs are borne by redeeming investors and not those remaining in the

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[10] Financial Stability Board consultation report, at 33.
[11] 86 Fed. Reg., at 8945.
[12] The Schwab Value Advantage Money Market Fund, for example, increased its WLAs from approximately 37% at the end of February 2020 to about 43% by early April 2020.
[13] See e.g., comments of Eric J. Pan, President & CEO, Investment Company Institute (available at https://www.sec.gov/comments/s7-01-21/s70121-8662926-235321.pdf) and comments of Lindsey Keljo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association Asset Management Group (available at https://www.sec.gov/comments/s7-01-21/s70121-8664048-235345.pdf) to the President's Working Group on Financial Markets.

fund. A floating NAV, however, would ensure that all investors are clear at all times about the price at which they are redeeming shares. Moreover, swing pricing would re-introduce the concept of a threshold – a concept that much of the industry agrees has not served investors well in the case of the thresholds for triggering fees and gates. As the FSB notes, "There is also a risk that investors anticipate changes in parameters by authorities and redeem pre-emptively, which could have broader effects than actions undertaken by individual funds."[14] Implementing swing pricing in the money market fund context would be enormously burdensome for fund sponsors and broker-dealers. In an environment in which funds already have a floating NAV, we see no need for imposing an additional layer of regulation.

Policy Reforms to Strengthen Short-Term Funding Markets

Finally, Schwab believes strongly that the events of March 2020 were not specific to money market funds and, therefore, is also supportive of any structural reforms that bring greater liquidity and transparency to the short-term markets. Improving the liquidity of short-term securities is the best way to address frozen markets across all investment types, not just money market funds. The emergence of a global pandemic caused an unprecedented liquidity crisis across a wide variety of markets in March 2020. We believe that our recommendations – indeed, any of the FSB's reform recommendations – will not be effective unless paired with structural reforms to these markets. Improving underlying market liquidity, particularly in the repo and commercial paper markets, would minimize price dislocation and reduce volatility. The recommendations outlined in the FSB's consultation paper, including faster settlements, increased market transparency and additional regulatory reporting across a broader spectrum of short-term funding market participants and investors, are all worth consideration.

Conclusion

To address that the stresses that buffeted the money market fund markets in 2008 and 2020 do not repeat, Schwab recommends that global regulators require prime and municipal money market funds to transparently and accurately reflect the reality that their net asset value is not constant. Doing so would also reinforce to retail investors that their investment carries risk and is not guaranteed. Such a requirement could supplement our other key recommendations – structural reforms that increase liquidity and transparency in, and oversight of, the short-term markets and the severing of the link between liquidity thresholds and the ability of a fund board to impose fees and gates – and result in a stronger, more stable market environment that will reduce the likelihood of government intervention and improve the functioning and resiliency of the markets.

Thank you very much for the opportunity to comment.

Sincerely,

Rick Wurster

Rick Wurster
Managing Director, Schwab Asset Management Solutions

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[14] Financial Stability Board consultation report, at 30.