GARP Global Association of Risk Professionals
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Mr. Dietrich Domanski
Secretary General
Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
Ch-4002 Basel, Switzerland

Dear Dietrich,

This letter is a response to the FSB's Consultation Report "Policy Proposals to Enhance Money Market Fund Resilience" dated 30 June 2021.

We sent a letter to you on October 9, 2020 with an analysis "Money Market Fund Reforms: Pros and Cons of Options." We believe those who produced the Consultation Report were attentive to it (thank you for that).

This letter makes two points:

1) During your virtual consultation meeting on Monday July 12, many participants argued for no or only limited reforms. We are skeptical such an approach will be effective. We offer a few comments.
2) We suggest that the effectiveness of reform might be enhanced by a forced split of "prime" money market funds into a set that holds only financial paper and another set that holds only non-financial paper. This will not fix all the problems but may simplify the design and sale of reforms.

The July 12 Webex

We agree with the remarks of Scharfstein, Metrick, Portes and Tucker, which we summarize as suggesting that prime money market funds, money market fund investors, and issuers of money market fund investments should not be allowed to continue to impose material financial stability costs on society. It may be necessary to impose costs on some funds, fund investors, and issuers of paper in which the funds invest. That may mean some types of money market funds and some types of paper will disappear, but the economic impact of such disappearance should be modest. Asset prices and financial flows will adjust if policy changes are made clear well in advance.

We agree that liquidity buffers should be usable in stress situations.

We urge more pressure in your final report on nations to implement effective policy reforms. Those nations that do not implement reforms may enjoy benefits of regulatory arbitrage for a period of time, but in the end will impose costs on the rest of the world.

We are skeptical that changes in CP, CD and repo market microstructure will fix the problems seen in 2008 and 2020. During crisis periods when almost all market participants want to sell, almost none want to buy, and the system depends on sound paper trading near par, changes in microstructure will not relieve crisis pressures.

Benefits of a Split

A common concern about changes to financial regulation and to the financial system is the impact on financing of real economic activity. Table 1 in your consultation report implies that direct investments by money market funds in paper issued by non-financial entities is only about $160 billion (ignoring China and

Japan), whereas financial CP and CDs total about $925 billion (and repo another $1.4 trillion). Thus, the vast majority of investments by non-government money market funds support real activity indirectly, for example by providing banks with funding that they might use to lend to real-economy entities or to support trading of financial assets.

We suggest that non-government money market funds be forced to split into two types, one that invests only in non-financial paper fully backed by backup lines of credit arranged at banks by issuing firms, and one that invests only in financial paper. This split would not remove the risk that severe stress might limit money market investors' ability to redeem, but it would reduce the transmission of money market fund stress to real economic activity.

In a crisis, the suggested prime non-financial funds would impose less stress on issuers of funds' investments because, in the event that money market funds could not roll over investments, issuers could turn to backup lines of credit. Because the backup lines would be issued by banks and banks have access to central bank support, the banks would be able to honor backup line requests and non-financial issuers would continue to receive financing. Unusual central bank facilities would not be needed to support non-financial firm financing.

In a crisis, the suggested prime non-financial money market funds might find themselves unable to satisfy redemption requests, and fund investors' loss of access to their balances might have real effects, so the split does not eliminate financial instability. Such instability might be further reduced by requiring prime non-financial funds to maintain bank lines of credit sufficient to support redemptions beyond available liquidity buffers. No unusual central bank facilities would be needed for the reason noted above. Of course, such lines of credit might be costly and prime non-financial money market funds might shrink.

Turning to the prime financial money market funds we suggest, we suspect that banks are the predominant issuers of financial paper and, crucially, banks can turn to existing central bank facilities to replace funding that money market funds are unable to roll over during periods of stress. Thus, banks would continue to be able to issue liabilities and to finance real activity by making use of the existing safety net.

As in the case of the proposed prime non-financial money market funds, prime financial money market funds might find themselves unable to satisfy redemption requests. Because of the aggregate size of such funds, we are skeptical that forcing them to have bank lines of credit would enable them to redeem any amount of liabilities in a crisis. Our October 9, 2020 letter discusses pros and cons of several reforms directed at this problem.

Splitting prime money market funds into non-financial and financial types is not a solution to the whole problem that you are attempting to address. But it would remove financing of real economic activity as a direct consequence of money market fund distress, which would be helpful.

Thank you for your attention to the important policy matter of money market fund reform.

Yours truly,

/s/ Richard Apostolik	/s/ Mark Carey
President and CEO	Co-President, GARP Risk Institute