M|E|W *Consul*

Max-Stromeyer-Str. 116
78467 Konstanz/Germany

Tel/Fax +49 (7531) 363 2918
Email info@mewconsul.de
Internet www.mewconsul.de

June 19, 2021

Financial Stability Board
c/o Bank for International Settlements

Basel, Switzerland

Via Email: fsb@fsb.org

Policy Proposals to Enhance Money Market Fund Resilience - MMF policy proposals

Recommendation for policy action, seize opportunity and prepare for digital future

Ladies and Gentlemen,

Up to now money market funds (MMF) were a major tool for non-financial corporations (NFC) among others to manage strategic liquidity risks. But, when looking to strengthen regulation of MMF, one should not solely focus on past experiences and current infrastructure. Financial market infrastructure (FMI) is in transition already, i.a. from analogue to digital, from static to dynamic, from delayed to real time.

For example, since start of Covid-19 pandemic the market share of digital payments has increased significantly. Various European and Asian central banks have implemented there own instant payment architecture already, independent from private sector. Next in the planning are central bank digital currencies (CBDC).

At present, Federal Reserve (Fed) is executing FedNow initiative, will introduce their own architecture by 2023. Due to reserve currency status of U.S. Dollar, it will have a major impact. As a result of automation of payments and digitization in general, according to Bank of England analysis, future bank runs can be as fast as 30 minutes.

1st interim result, changes to MMF regulation shouldn't focus on current situation and historic experience alone, but should consider digitized, instant FMI as well.

Liquidity risk of private individuals is already addressed via bank deposit insurance schemes. Banks, and indirectly states, can access central bank liquidity facilities, are taken care of as well. The last remaining gaps are NFC and non-bank financial institutions (NBFI).

As outlined in FSB consultation report and mentioned during the panel discussion, MMF and short term funding markets (STFM) have to be evaluated in context. We have two issues to be addressed, and so far only one tool available, regulation. That is technically impossible to solve, what is needed is a second tool.

In case of volatility events for whatever reason STFM demand is rising, f.i. regulation driven, collateralization of derivative transactions, while at the same time MMF experience higher level of redemptions. The problem of pro-cyclicality of liquidity and collateral management (variation margin) is well known, has been thoroughly analysed by amongst others central banks, regulatory authorities, and private sector as well.

The only logical conclusion therefore, before we can discuss improving MMF regulation, and mitigate potential systemic risk, etc., MMF and STFM have to be decoupled during times of financial system stress and market volatility.

2nd interim result, the key to achieve resilient MMF regulation is first to shield STFM from feedback loops during times of market turbulences.

Financial markets are cyclical. Financial regulation is cyclical as well. As a result, regulated financial institutions (FI) are also acting cyclical. Digitization defined as platform economy is reinforcing cyclicality. Instant FMI, including instant payments, will make system more efficient, which is great during stable environment, but increases risk level during times of stress.

Currently, when markets are not in balance following an internal or external shock, they do not return to a stable equilibrium. Without central bank interventions situations would spiral out of control, volatility continuously rise and financial system ultimately collapse.

3rd interim result, to break cyclical feedback loop, additional countercyclical structure is urgently needed, backstop or liquidity insurance, acting as automatic stabiliser.

International central banks and regulatory authorities are well aware about the risks of cyclicality and feedback loops. It has been thoroughly analysed as well, from various perspectives, including MMF, collateralization of centrally cleared derivative transactions (variation margin), and also instant payments. That is why FedNow has decided to also establish automatic stabiliser for NFC and smaller FI when introducing their instant payment infrastructure, directly supporting newcomer and disruptive business models via innovation hub.

During the panel discussion on July 12, all contributions were based on existing business model. Digitization and innovation were not even mentioned. Existing FI, banks, asset manager, insurance companies, FMI provider, have no incentive to change the current system, put their revenues at risk. Established FI act as gatekeepers, innovation is only accepted to improve their existing business models. As a result, so far innovation defined as disruption is only successfully initiated with public support or unregulated big tech companies, see for example digital payment.

That is why panel discussion was continuously arguing in a circle. Banks and asset managers have no economic interest in true reform and more reliable regulation. They would loose the implicit central bank put, protecting them during times of disruption. With the introduction of automatic stabilisers, NFC would be protected from financial market disruptions, and default of FI no longer a serious threat. FI would be evaluated on a stand alone basis, cost of doing business initially increase during stable times. But cost of stabilization and/or bail out of FI would no longer be passed on to the general public. As a result, the overall cost over a whole credit/economic/ risk cycle would be mixed for FI and lower for general public. Principle-agent problem addressed for good.

4th interim result, impact of automatic stabilisers will be mixed to existing FI, incl. MMF, while reducing the burden to general public. Privatised profits combined with socialised bail-out costs a thing of the past.

M|E|W Consul has discussed the above structural issues of cyclicality, feedback loops and systemic weaknesses with various central banks over the course of the last several years, plus has participated in numerous regulatory consultations. The result, two completely new automatic stabilisers have been developed:

1. KLF - liquidity back-up insurance, plus
2. RCR - regulatory capital reserve facility

In case of future disruptions, KLF will provide insured businesses (FI/NFC) with HQLA in real time – 24/7/365. HQLA liquidity can be guaranteed by central bank without taking credit risk or moral hazard. Insured businesses will have similar protection as major FI. New safety architecture protects insured businesses from financial system disruption. KLF automatic stabiliser allows addressing challenges of real time FMI, including instant payments and MMF.

RCR was developed addressing risks especially of systemically relevant banks (G-SIB) and FMI provider (CCP and CSD), providing automatic capital injections in case of emergency. Naturally RCR also fully automated with execution in real time - 24/7/365.

5th interim result, KLF by M|E|W Consul is an example for an automatic stabiliser, separating MMF and STFM during times of financial system stress, providing instant protection - 24/7/365.

Supporting innovation directly via innovation hub, against the interest of established market participants, is the first major step by US authorities. Additionally FDIC will implement a new standard setting organization (SSO).

Objective of SSO is to support innovation focussing on smaller FI, NFC, etc. So far large FI are dominating financial product development, limiting progress to their economic interests and their major clients. It is obvious, that the interests of others, such as smaller FI and NFC, are not sufficiently taken into consideration. FSB panel discussion was another example for that. All arguments and suggestions from industry side were based on the interests of MMF sponsors and systemic relevant banks, STFM impact only considered when to their advantage.

To achieve reliable changes in structure and regulation of MMF, solutions will not be provided from established market participants. Gatekeeper position of large FI has to be eliminated, true innovation fostered.

6th and final result, key to lasting MMF regulation is digitization and innovation. To support newcomers, initiatives such as BIS innovation hubs should be more open, accompanied by new regulatory institutions such as FDIC/SSO for certification in other jurisdictions as well.

As soon as automatic stabilisers are widely rolled out financial regulation including MMF can be implemented without consideration for other markets such as STFM, and other market participants such as NFC. With cyclicality no longer an issue, gates or liquidity thresholds as part of MMF reform are no longer disruptive, defaults of large FI and MMF manageable. Structural shortcomings of financial market structure considerably mitigated, new challenges due to digitization of FMI addressed.

In summary, our recommendation for policy action, seize this opportunity and prepare for digital future:

1. **focus on major structural weakness of financial system, instead of details and segments**
2. **incorporate new architecture and new developments, which are already in the planning**
3. **foster digitization and true innovation, against resistance of existing market participants**
4. **recognize U. S. certification in other jurisdictions, introduce certification internationally**
5. **support adoption of automatic stabilizers globally, hence address new digital detriments**

Best regards,

Manfred E. Will

Founder & CEO