INVESTMENT COMPANY INSTITUTE

April 11, 2022

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Money Market Fund Reforms

Dear Ms. Countryman:

The Investment Company Institute (ICI)[1] appreciates the opportunity to provide its views on the Securities and Exchange Commission's proposed amendments to certain rules that govern money market funds under the Investment Company Act of 1940.[2] Today, over 50 million retail investors, as well as corporations, municipalities, and other institutional investors, rely on the $5.0 trillion money market fund industry[3] as a low cost, efficient, transparent, cash management vehicle that offers market-based rates of return.[4]

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[1] The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions. Its members manage total assets of $31.0 trillion in the United States, serving more than 100 million investors, and an additional $10.0 trillion in assets outside the United States. ICI has offices in Washington, DC, Brussels, London, and Hong Kong and carries out its international work through ICI Global.

[2] *See* Money Market Fund Reforms, SEC Release No. IC-34441 (December 15, 2021) (Release), available at https://www.sec.gov/rules/proposed/2021/ic-34441.pdf.

[3] Data are as of February 2022 and include nonpublic institutional prime money market funds. Nonpublic institutional prime money market funds are not offered for sale to the general public but are registered under the Investment Company Act and comply with Rule 2a-7. Asset managers use these funds, often referred to as "internal prime cash management funds" or "central prime cash funds," as internal cash management vehicles for their long-term mutual funds.

[4] Yields on money market funds are typically higher—sometimes substantially so—than rates banks generally offer on money market deposit accounts (MMDAs). Since 1990, ICI estimates that money market fund shareholders have earned an estimated $546 billion more in dividend income than they would have earned in MMDA interest.

Money market funds also are an important source of direct financing for governments (federal, state and local), businesses, and financial institutions, and of indirect financing for households. Without money market funds, governments, institutions, and individuals would need to seek more expensive, less transparent, and less efficient forms of financing.

ICI and its members are committed to working with the SEC to strengthen the money market fund industry for the benefit and further protection of investors and the performance of broader financial markets and the economy more generally. We hope our comments below provide analysis and data to guide the SEC as it considers how best to advance toward this important policy goal.

BACKGROUND

Given the important role of money market funds in the financial system, the SEC should evaluate reform options by comparing their impact on the ability of money market funds to fulfill this role (*i.e.*, preservation of their key characteristics) *against* the likely practical impact any money market fund reforms will have on making the overall financial system more resilient. Any new reforms for money market funds should be measured and appropriately calibrated, taking into account data, the costs and benefits these funds provide to investors, the economy, and the short-term funding markets. To this end, ICI and its members have previously analyzed and offered detailed and concrete feedback on a variety of reform options considered by policymakers since March 2020, including some of the reform options set forth in the Release.[5] We also have carefully collected data and analyzed the events of March 2020 and found that (i) money market funds were neither the first nor the largest targets of the government

[5] *See e.g*., Comment letter on the Financial Stability Board's Consultation Report on Policy Proposals to Enhance Money Market Fund Resilience from Eric J. Pan, President and CEO, Investment Company Institute (August 13, 2021) (2021 ICI Letter to FSB); Comment letters on the President's Working Group (PWG) Report on Money Market Funds from Eric J. Pan, President and CEO, Investment Company Institute, to Vanessa Countryman, Secretary, Securities and Exchange Commission (April 12, 2021), (2021 ICI Letter to PWG), available here; (May 12, 2021) available here (2021 ICI Money Market Fund Roundtable Summary); and (June 3, 2021) available here; Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (September 17, 2013) (2013 ICI Letter to SEC); Comment letter of the Investment Company Institute on Financial Stability Oversight Council, *Proposed Recommendations Regarding Money Market Mutual Fund Reform,* Docket No. FSOC-2012-0003 (January 24, 2013) (2013 ICI Letter to FSOC); Letter from Paul Schott Stevens, President & CEO, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (January 10, 2011) (comment letter to the 2010 PWG Report on Money Market Fund Reform Options (File No. 4-619)) (2011 ICI Letter to PWG); Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (September 8, 2009) (commenting on the SEC's proposed money market fund reforms); Investment Company Institute, Report of the Money Market Working Group (March 17, 2009) (2009 MMWG Report).

intervention programs that helped a broad range of financial market participants during the COVID-19 crisis and (ii) money market funds did not cause the stress in the short-term funding markets in March 2020.[6] Indeed, the COVID-19 crisis revealed reluctance or inability by certain banks to act as dealers in such circumstances and different expectations between investors and the role of dealers in providing liquidity in these markets. To this end, we agree with commentators that have recommended measures that would adjust bank regulations to enable banks and their dealers to expand their balance sheets to provide market liquidity during stress without materially reducing the overall resilience of those firms.[7]

It was the structure of that market during times of stress—not the action of money market funds—that was at the heart of the ensuing challenges of March 2020. To this end, money market fund reforms by themselves will not address these challenges. We urge the SEC, working together with other policymakers and the industry, to focus on measures that would improve the functioning of those markets.[8]

EXECUTIVE SUMMARY

Our comments and recommendations, include the following:

- *Amendments to remove liquidity fee and redemption gate provisions*. We agree that the regulatory tie between liquidity thresholds and fee and gate thresholds

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[6] For a detailed discussion of ICI's research of the March 2020 events and the role of money market funds, *see* 2021 ICI Letter to FSB, *supra* note 5, at Sections 1 and 2; 2021 ICI Letter to PWG, *supra* note 5, at Section 4; "Experiences of US Money Market Funds During the COVID-19 Crisis," Report of the COVID-19 Market Impact Working Group (November 2020) (2020 ICI Money Market Fund Report).

[7] *See e.g.*, *Task Force on Financial Stability*, Brookings Institution (June 2021), available at www.brookings.edu/wp-content/uploads/2021/06/financial-stability_report.pdf, at 11-12. Specifically, the report recommends permanently excluding reserves from the supplementary leverage requirement (SLR) or considering a countercyclical component of the SLR to be released in stress. *Id*. at 40-42.

[8] For a discussion of measures to improve the Treasury market, *see e.g.*, *Recent Disruptions and Potential Reforms in the U.S. Treasury Market*: *A Staff Progress Report*, staff findings from the U.S. Department of the Treasury, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (November 8, 2021), available at https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf; *Task Force on Financial Stability*, Brookings Institution (June 2021), available at www.brookings.edu/wp-content/uploads/2021/06/financial-stability_report.pdf, at 43-45; Group of Thirty Working Group on Treasury Market Liquidity, *U.S. Treasury Markets: Steps Toward Increased Resilience*, Group of Thirty (2021), available at group30.org/publications/detail/4950, at 9-14. For an example of a similar government and industry initiative, *see* the Task Force on Tri-Party Repo Infrastructure ("Task Force") at www.newyorkfed.org/tripartyrepo/index.html. The Task Force was formed in September 2009 to address potential systemic risk concerns associated with the infrastructure supporting the triparty repo market. The Task Force membership included representatives from multiple types of market participants that participate in the tri-party repo market, as well as relevant industry associations, including ICI. Federal Reserve and SEC staff participated in meetings of the Task Force as observers and technical advisors.

made money market funds more susceptible to financial stress in March 2020 and could likely do so again in future periods of stress. ICI data indicates, and our members report, that the possibility of a gate especially caused investors in March 2020 to redeem heavily when a fund started approaching 30 percent weekly liquid assets—a level that only had significance because of the bright line drawn by the regulatory tie rather than actual difficulties in the fund's ability to meet redemptions. An ICI analysis also shows that this regulatory tie, and the heightened level of redemptions it caused during March 2020, would rapidly overwhelm the available weekly liquid assets of a typical institutional prime money market fund in about two weeks. But, without the tie, the analysis demonstrates that, even with very substantial redemptions, this same fund would have stabilized at more than 20 percent of its assets in weekly liquid assets *more than five weeks into the crisis*, showing that the fund would have been able to continue to satisfy redemption requests without assistance. With a higher level of weekly liquid assets (such as 40 percent), even with very substantial weekly outflows, weekly liquid assets in institutional prime money market fund would have stabilized at about 30 percent of fund assets in a few weeks. **(Section 1.1)**

- *Proposed swing pricing requirement*. We strongly disagree with the proposed swing pricing requirement (and the related proposed disclosure and reporting requirements). Swing pricing fails to reflect how money market funds are managed, would not advance the SEC's goals of enhancing money market fund resiliency and by extension financial stability,[9] would likely strip money market funds of features that are key to investors (such as multiple daily net asset value (NAV) strikes per day and same-day settlement), and would impose excessive costs to overcome unnecessary and complex structural challenges. Indeed, swing pricing will fundamentally alter the product and its appeal to investors, cause fund sponsors to stop offering the product, and is neither supported by the data nor necessary. Rather, the evidence indicates—and the SEC has admitted—that the SEC's 2014 amendments that tied the liquidity thresholds with the option of gates and the possibility of a 2 percent liquidity fee was a mistake that contributed very significantly, perhaps predominantly, to the stresses prime institutional money market funds experienced in March 2020. Nevertheless, if the SEC chooses to ignore the evidence and insists on imposing an anti-dilution mechanism (ADM) on certain money market funds, the SEC could modify and leverage the existing fee framework. Similar to retail money market funds, and as supported by data, however, nonpublic institutional prime money market

[9] *See* Statement before the Financial Stability Oversight Council on Money Market Funds, Open-End Bond Funds, and Hedge Funds, Chair Gary Gensler (February 4, 2022).

funds do not need special provisions as demonstrated by their lower levels of redemptions in periods of stress. **(Section 1.2)**

- *Amendments to portfolio liquidity requirements*. As economic analysis shows, a modest increase in the daily and weekly liquid asset requirements—consistent with what most public prime money market funds already maintain as a matter of conservative liquidity risk management—and importantly in combination with the amendments to remove the current liquidity fee and redemption gate provisions—would bolster the resiliency of money market funds sufficiently to avoid another March 2020 like event. To this end, we recommend the SEC increase daily and weekly liquid asset requirements to 20 percent and 40 percent, respectively. We also generally support a requirement that would require a fund to notify its board upon a "liquidity threshold event," provided the definition of such event is adjusted to require board notification when daily liquid assets and weekly liquid assets go below 10 percent and 20 percent, respectively (half of our proposed liquidity levels). **(Section 1.3)**

- *Proposed amendments to liquidity metrics in stress testing*. We support the SEC's proposal that would no longer require funds to test their ability to maintain 10 percent weekly liquid assets under the specified hypothetical stress events described in Rule 2a-7 and instead require funds to test whether they are able to maintain sufficient minimum liquidity under each specified hypothetical event. **(Section 1.4)**

- *Amendments related to potential negative interest rates*. We strongly oppose a requirement that government and retail money market funds must determine that each financial intermediary has the capacity to redeem and sell securities issued by a fund at a floating NAV per share or prohibit the financial intermediary from purchasing the fund's shares in nominee name. Imposing this requirement on these funds is neither necessary nor relevant to the redemption pressures experienced by other money market funds in March 2020, would be prohibitively expensive for many financial intermediaries, and may drastically reduce these important funds for the short-term funding needs of investors and the direct financing for governments, businesses, and financial institutions. **(Section 1.5)** Further, the proposed provision to prohibit reverse distribution mechanisms (RDM) or reverse stock splits should not be included in the final amendments because such tools should be available to funds to use in a negative interest rate environment. RDM and reverse stock splits should be permitted to preserve many investors' preference for a stable NAV money market fund investment. **(Section 1.5.2)**

- *Amendments to specify the calculation of weighted average maturity (WAM) and weighted average life (WAL)*. We support the SEC's proposal to require that money market funds calculate WAM and WAL based on the percentage of a security's market value in the portfolio. **(Section 1.6)**

- *Amendments to reporting requirements*. We do not support a proposed new requirement that would require a money market fund to file a report on Form N-CR when a liquidity threshold event occurs unless such reports are filed confidentially (and remain confidential) with the SEC. Since investors can already see liquidity levels on funds' public websites, these disclosures on Form N-CR may needlessly increase investor sensitivity to liquidity levels. **(Section 1.7.1)** Given the sheer volume of new information and the increased frequency of certain data points proposed for Form N-MFP, five business days is insufficient time to prepare the necessary detailed filing and urge the SEC to extend the filing period to seven business days. We also have concerns regarding proposed new class-level information and the level of proposed information in Part C of Form N-MFP. **(Section 1.7.2)**

- *Compliance dates*. The SEC should provide at least two years (rather than the proposed 12-month compliance period) following issuance of final SEC rules to allow the industry to complete the broad client service and operational requirements necessary to successfully implement any new reforms that will dramatically change the industry. A 12-month compliance period (rather than a 6-month period) also is necessary to transition to any increased liquidity requirements and the new reporting requirements. **(Section 2)**

- *PWG Report Reform Options*. We support the SEC's decision not to include other reform options discussed in the PWG Report, such as minimum balance at risk, capital buffers, and liquidity exchange bank membership. The likeliest impact of any of these options would be to decrease the utility and attractiveness of these products to investors and cause fund sponsors to exit the industry. **(Section 3)**

1. Consideration of SEC's Proposals

The Release discusses a number of proposed amendments to rules that govern money market funds under the Investment Company Act. We discuss the SEC's proposals in the same general order as set forth in the Release.

1.1 Amendments to Remove Liquidity Fee and Redemption Gate Provisions

The Release proposes removing the tie between liquidity thresholds and fee and gate provisions, and, moreover, to remove fee and gate provisions from Rule 2a-7 entirely.[10] Rule 2a-7 currently provides that a money market fund may impose a liquidity fee of up to 2 percent, or temporarily suspend redemptions (*i.e*., impose a "gate"), if the fund's weekly liquid assets fall below 30 percent of its total assets and the fund's board of directors determines that imposing a fee or gate is in the fund's best interests. The rule also includes a default liquidity fee if a fund's weekly liquid assets fall below 10 percent, unless the board determines that a fee would not be in the best interests of the fund.

The Release acknowledges that in March 2020, even though no money market fund imposed a fee or gate, the possibility of a gate or an immediate 2 percent liquidity fee if a fund's weekly liquid assets dropped below 30 percent appears to have contributed to investors' incentives to redeem from prime money market funds and for fund managers to maintain weekly liquid asset levels above the threshold, rather than use those assets to meet redemptions. The Release states that these tools therefore appear to have potentially increased the risks of investor runs without providing benefits to money market funds as intended. The SEC's analysis and external research are consistent with ICI's views (as discussed below) on investor behavior, which found that institutional prime money market funds whose weekly liquid assets approached the 30 percent threshold had, on average, larger outflows in percentage terms than other prime money market funds, despite the fact that these funds still had very substantial highly liquid assets with which to meet redemptions.

We agree that the current fee/gate framework made money market funds more susceptible to financial market stress in March 2020 and could likely do so again in future periods of stress. More specifically, ICI members report that investors were most concerned about their continued access to liquidity if a fund were to impose a gate (a regulatory requirement that differentiates prime money market funds from other cash alternatives in the short-term fund markets) and *less concerned* about the possibility of fees, or more generally, about the possibility of losing principal. Indeed, the possibility of a gate caused investors in March 2020 to redeem heavily when a fund started approaching 30 percent weekly liquid assets—a level whose only significance was to draw a bright line for investors to avoid and nothing to do with a fund's ability to meet redemptions.

[10] Under the proposal, a money market fund would continue to be able to suspend redemptions to facilitate an orderly liquidation of the fund under Rule 22e-3 (consistent with ICI's recommendation). The Release also notes that although the proposal would remove the liquidity fee provision in Rule 2a-7, a money market fund's board may nonetheless approve the fund's use of redemption fees (up to 2 percent) under Rule 22c-2.

ICI members indicate, and ICI data confirm, that by mid-March 2020 institutional investors accelerated their redemptions for those institutional prime money market funds that started *approaching (but not reaching)* the 30 percent weekly liquid asset threshold because these investors knew that reaching 30 percent could lead to the imposition of high fees or gates.[11] ICI members reported that outflows began in some institutional prime money market funds as early as when their weekly liquid assets started falling below 40 percent and accelerated when those weekly liquid assets fell below 35 percent.[12] Given that investors could not predict whether a fund would impose a gate if the fund reached this threshold, 30 percent in effect became what might be described as a "concrete air bag," a hard liquidity floor rather than a liquidity cushion to absorb higher-than-usual redemptions, as the SEC had hoped.[13] Indeed, this regulatory constraint necessitated prime money market funds' need to divest longer-dated securities in favor of securities that qualified as weekly liquid assets.[14]

In March, outflows accelerated among institutional prime money market funds, depleting their weekly liquid assets and increasing the number of institutional prime

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[11] This observation was echoed in an October 2020 report by the SEC's Division of Economic and Risk Analysis, which noted that "some investors may have feared that if they were not the first to exit their fund, then in the event the fund breached the 30 percent WLA [weekly liquid asset] limit, there was a risk that they could be subject to restrictions on withdrawals known as "gates." This anticipatory, risk-mitigating perspective potentially further accelerated redemptions." *See* Securities and Exchange Commission, Division of Economic and Risk Analysis, *US Credit Markets: Interconnectedness and the Effects of the COVID-19 Economic Shock* (October 2020), available at www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf. US Secretary of the Treasury Janet Yellen, before her nomination as Treasury Secretary, also expressed concern about the fees and gates requirement when she lamented that the SEC's 2014 money market fund reforms "did something that almost all [economists], including most people in the Fed…are very unhappy about, they allowed funds or insisted that they impose gates and redemption fees once liquidity fell below a minimum. Most economists thought that the erection of the gates by one fund would cause outflows [and] contagion as people tried to avoid having that happen to them. I think that's exactly what happened." *See* Remarks delivered at a Bookings Institution webinar, "A Decade of Dodd-Frank" (June 30, 2020), available at www.brookings.edu/events/a-decade-of-dodd-frank/.

[12] ICI members also noted that online trading platforms—which institutional investors use to purchase and sell money market funds—often automatically send investors electronic notices when a fund's weekly liquid assets drop below a certain amount (*e.g.*, 35 percent).

[13] Although SEC Rule 2a-7 imposes specific minimum requirements on the amounts of daily and weekly liquid assets, it does not prohibit a fund from dipping below these requirements. Rather, it provides specific remedies for restoring liquidity in cases where these minimum levels are breached. In particular, whenever a fund's daily liquid assets account for less than 10 percent of its total assets, the fund is prohibited from acquiring any new asset other than a daily liquid asset. Similarly, if a fund's weekly liquid assets make up less than 30 percent of its total assets, the fund cannot acquire any new asset other than a weekly liquid asset. These conditional restrictions on fund management are designed to help rebuild a fund's daily and weekly liquidity levels whenever these levels become too low.

[14] See 2021 ICI Letter to PWG, *supra* note 5, Section 4.

money market funds with weekly liquid assets in the 30 to 35 percent range.[15] Despite this stressful period, *only one institutional prime money market fund (out of a total of about 40) had weekly liquid assets of less than 30 percent* and even then by a very small margin (at 27.4 percent) that still left that fund with plentiful liquidity to meet redemptions.[16]

At the height of the crisis after three weeks of market turmoil and before the Federal Reserve announced the creation of the Money Market Mutual Fund Liquidity Facility (MMLF), institutional prime money market funds, though faced with significant redemptions, had plentiful liquidity levels that would have been sufficient to weather a severe liquidity event had money market funds been able to access this liquidity (but for the SEC's 2014 rule), as discussed below in Section 1.1.1.

These data suggest that some institutional investors were primarily focused on whether funds would hit the 30 percent level rather than whether there was actual evidence of the fund having difficulty meeting redemption requests. This caused much stronger outflows from those institutional prime money market funds with weekly liquid assets below 35 percent compared to other institutional prime money market funds.[17] At the same time, retail prime money market funds, which like institutional prime money market funds have the option of imposing fees or gates if weekly liquid assets fall below 30 percent, saw little difference in the average daily outflows with weekly liquid assets below 35 percent.[18]

In contrast to fees, gates deny investors access to their cash, which is highly problematic when investors have immediate cash flow demands, as was expected in March 2020, when the federal government effectively closed down the US economy. Based on the experience of certain money market funds in March 2020 and analysis of data, the mere prospect of gates lead investors (especially institutional) to engage in preemptive redemptions. To this end, members report that investors view access to their money as paramount during a period of market stress and are less concerned with "losing a few pennies."

As such, we strongly support the SEC's proposal to limit the use of gates to extraordinary circumstances that present a significant risk of a run on a fund and potential harm to investors, consistent with Rule 22e-3 under the Investment Company

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[15] *See* 2020 ICI Money Market Fund Report, *supra* note 6, at Figure 3.17.

[16] *Id.* at Figure 3.18. Even though the fund's weekly liquid assets dipped below 30 percent, the fund did not impose fees or gates. By March 20, the fund's weekly liquid assets increased to 40.6 percent.

[17] *Id*. at Figure 3.19.

[18] *Id*. at Figure 3.20.

Act, which permits a money market fund to suspend redemptions *only* to facilitate an orderly liquidation of the fund.

1.1.1 ICI Analysis of Redemption Restrictions

ICI members have uniformly indicated that in March 2020 investors accelerated their redemptions because of concerns that funds might impose gates. This is consistent with the data, which show that outflows accelerated significantly from institutional prime money market funds whose weekly liquid assets fell below 35 percent. Evidence further suggests that removing the tie between the 30 percent weekly liquid asset requirement and gate thresholds would be sufficient to address the SEC's and other policymakers' concerns regarding money market funds.

To test this conclusion, ICI conducted an analysis showing that the tie increased the rate of redemptions at a pace that rapidly overwhelmed the available weekly liquid assets. Absent the regulatory tie, redemptions—although significant—could have been met as term securities matured into weekly liquid assets, without *any* need for asset sales.

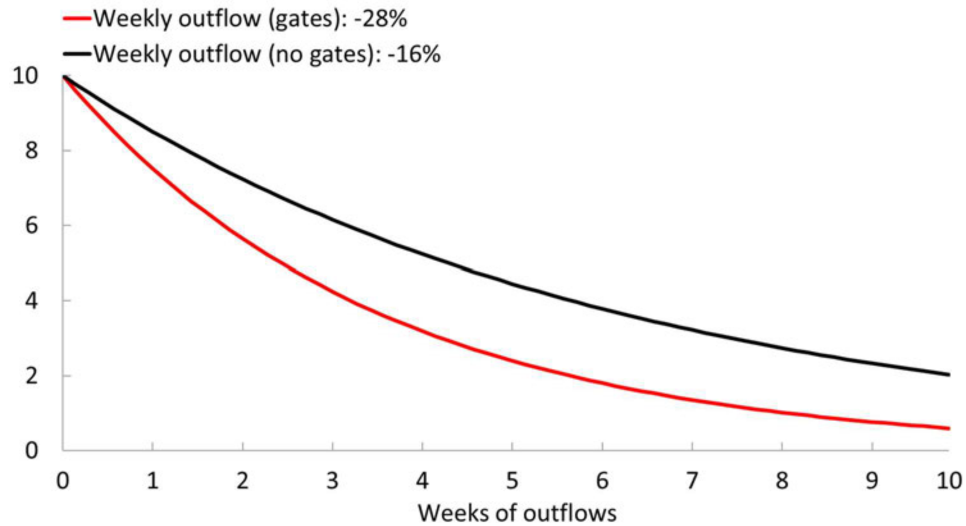
The analysis uses a simulation based on actual daily redemptions in March 2020 and other data-based assumptions of a hypothetical institutional prime money market fund under three scenarios.

- The first scenario assumes, consistent with current regulatory requirements, that an institutional prime money market fund has the option of imposing redemption restrictions ("gates") if the fund's weekly liquid assets fall below 30 percent.
- The second scenario assumes that an institutional prime money market fund does not have the option of imposing redemption restrictions whatever its level of weekly liquid assets ("no gates"), which would have been the case but for the SEC's 2014 rule provisions.
- The third scenario is similar to the second (*i.e.*, "no gates") but additionally assumes that the fund starts with weekly liquid assets of 40 percent, consistent with a new, higher minimum level that we suggest in Section 1.3.

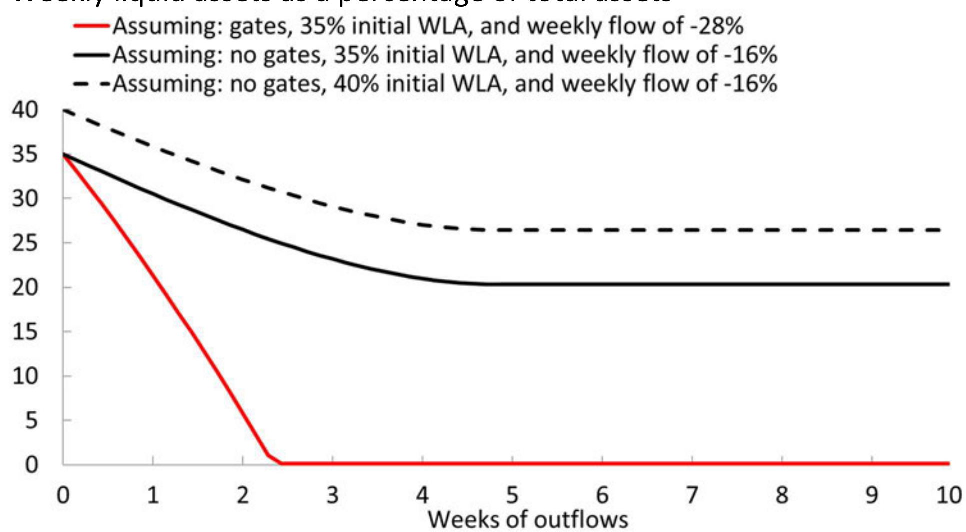
Consistent with money market fund providers' experiences in March 2020, assets fall more quickly with the possibility of redemption restrictions ("gates") once the institutional prime money market fund's weekly liquid assets fall below 35 percent because investors, concerned that funds might impose redemption restrictions once the 30 percent level is breached, redeem more heavily (red line, top panel of Figure 1). The simulation assumes that the fund experiences weekly outflows of 28 percent, which is consistent with the level of outflows in March 2020 from prime institutional money market funds whose weekly liquid assets approached or fell below the 30 level at which gates might be imposed. To meet these heavier redemptions, the fund uses its weekly liquid assets at a rapid pace, entirely depleting its weekly liquid assets within two weeks (red line, bottom panel of Figure 1).

FIGURE 1
Gates Option May Have Caused Destabilizing Feedback in Prime Money Market Funds

Simulated total assets, billions of dollars



Weekly liquid assets as a percentage of total assets



Note: Simulations assume that the fund starts with $10 billion in assets. The red line assumes that a fund has the option of imposing gates if its weekly liquid assets fall below 30 percent of its assets. The solid and dashed black lines assume the fund does not have the option of imposing gates at any level of weekly liquid assets. The red and solid black lines assume the fund initially has weekly liquid assets of 35 percent, whereas the dashed black line assumes the fund initially has a higher, 40 percent level of weekly liquid assets.

Absent the possibility of gates, the institutional prime money market fund faces lower (although still very significant) redemptions because investors do not fear the redemption restrictions if weekly liquid assets fall below 30 percent. In this case, we assume that the fund experiences weekly outflows of 16 percent, consistent with the typical experience in March 2020 of prime institutional funds whose weekly liquid assets remained well above the 30 percent level. Although the fund's assets still fall rapidly because of the redemptions, the weekly liquid assets decline much less sharply. This is because the fund's weekly liquid assets decline as the fund meets redemptions, but are replenished to a significant degree as other, somewhat longer-dated, assets roll into the fund's weekly liquid asset bucket. Under this scenario, the analysis shows that *even after five weeks into the crisis* the fund still had more than 20 percent of its assets in the form of weekly liquid assets with which to meet redemptions (solid black line in the bottom panel of Figure 1). Moreover, as the figure shows, even though in ensuing weeks the fund continues to see redemptions of 16 percent per week, its weekly liquid assets, rather than continuing to fall, stabilize at about 20 percent.

If the fund initially had weekly liquid assets of 40 percent—the new minimum we recommend the SEC adopt—weekly liquid assets again fall in the first several weeks (dashed black line), but stabilize after five weeks at nearly 30 percent, indicating that the fund can accommodate very substantial ongoing redemptions (16 percent per week) without running short of assets to meet future sizable redemptions.

These outcomes confirm that the purpose for the liquidity requirements in money market fund regulations—to ensure money market funds have a minimum percentage of their assets in highly liquid securities that can be readily converted to cash to pay redeeming investors—was turned on its head. Regrettably, the SEC's 2014 rule imposing a 30 percent threshold became a reason for investors to redeem out of a fund rather than a reason to remain in the fund.[19] It is important to reiterate that the 30 percent weekly liquid asset buffer became a floor that accelerated investor redemptions due to uncertainty about the imposition of liquidity fees or gates. To be a true buffer, it must serve as a source of liquidity in times of stress.

This indicates that eliminating the option of gates and raising the weekly minimum asset level to 40 percent should be more than sufficient to achieve the SEC's goals of increasing the resiliency of institutional prime money market funds.

1.2 Proposed Swing Pricing Requirement

The SEC is proposing a swing pricing requirement specifically for institutional prime and institutional tax-exempt money market funds. An institutional fund would "swing" its share price downward by an amount meant to approximate the portfolio transaction

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[19] Before the effective date of the SEC's 2014 money market fund reforms, which tied the liquidity thresholds (added in 2010) to fees and gates, prime money market funds regularly dipped below 30 percent with no adverse consequences. *See* 2021 ICI Letter to PWG, *supra* note 5, at 13-14.

costs generated when the fund experiences *net* redemptions (not net subscriptions).[20] Despite acknowledging the "dearth" of academic research about the degree to which dilution costs trigger money market fund runs,[21] the SEC puzzlingly claims that its proposed swing pricing requirement is designed to "ensure that the costs stemming from net redemptions are fairly allocated and do not give rise to a first-mover advantage or dilution under either normal or stressed market conditions." The SEC believes that past experience with the existing liquidity fee framework supports a mandatory approach to dilution mitigation for institutional funds. We strongly disagree and think the SEC's belief is not supported by evidence.

As noted above, removing the tie between the 30 percent weekly liquid asset requirement and the possibility of an immediate gate, or less concerning, a 2 percent fee, as well as increasing the minimum liquidity levels fully addresses the challenges money market funds experienced in March 2020. The data clearly support this change. Swing pricing, on the other hand, would fundamentally alter the product and its value to investors while being ineffective in enhancing the resiliency of money market funds and having no data to support its use. Simply put, members have indicated that they would stop sponsoring money market funds if the SEC adopts swing pricing.

Nevertheless, if the SEC persists in its view that an ADM is necessary for public institutional prime and institutional tax-exempt money market funds, the SEC could choose instead to modify and leverage the existing fee framework as discussed in Section 1.2.8.

We also believe that similar to retail money market funds, nonpublic institutional prime money market funds do not need special provisions as demonstrated by their lower levels of redemptions in periods of stress.

[20] In contrast, because retail prime and retail tax-exempt money market funds historically have experienced lower, more gradual levels of redemptions in stress periods than institutional funds, the SEC believes retail funds do not need special provisions allowing them to impose liquidity fees or other analogous tools under Rule 2a-7 given the expected effect of the additional liquidity requirements, as discussed below.

[21] Release at 158.

1.2.1 Mechanics of Proposed Swing Pricing Mechanism

Under the proposal, if an institutional fund has net redemptions for a pricing period,[22] the fund's current NAV per share would be "swung" down by a swing factor[23] reflecting spread costs[24] and other transaction costs (such as brokerage commissions, custody fees, and any other charges, fees, and taxes associated with portfolio security sales) from selling a vertical slice of the portfolio to meet those net redemptions. This means that when the per-share NAV is swung down, redeeming investors would receive less for their shares, essentially allowing funds to impose estimated transaction and other costs directly on those redeeming investors. At the same time, buyers would purchase shares at the reduced NAV.

If the institutional fund has net redemptions for a pricing period that exceed the market impact threshold,[25] the swing factor also would include good faith estimates of the

[22] "Pricing period" is defined as the period of time an order to purchase or sell securities issued by the fund must be received to otherwise be priced at a given current NAV under Rule 22c-1. This is designed to address money market funds that compute their NAVs multiple times per day.

[23] "Swing factor" is defined as the amount, expressed as a percentage of the fund's NAV and determined pursuant to the fund's swing pricing policies and procedures, by which a fund adjusts its NAV per share. Unlike the mutual fund swing pricing rule provisions (Rule 22c-1(a)(3)), the definition does not include an upper limit.

[24] Including the spread costs in the swing factor calculation effectively requires a fund to value a security in its portfolio at the bid price when the fund has net redemptions. It is our understanding that most money market funds typically use bid prices to value their portfolio securities.

[25] "Market impact threshold" is defined as an amount of net redemptions for a pricing period that equals the value of 4 percent of the fund's NAV divided by the number of pricing periods the fund has in a business day, or such smaller amount of net redemptions as the swing pricing administrator determines. This definition would require a fund to divide 4 percent of the fund's NAV by the number of daily pricing periods to arrive at the amount of net redemptions that would trigger application of the market impact factor. Because the number of pricing periods may vary among funds, this aspect of the definition is designed to provide a threshold that would apply more consistently to funds with different numbers of pricing periods, as opposed to a static figure applicable to all funds. For example, if a fund computes a NAV three times a day, its market impact threshold would be 1.33 percent per period (4 percent divided by 3). Therefore, if net redemptions in any of the three daily periods exceeds 1.33 percent, the swing factor for that particular period must include market impact. To establish the amount of net redemptions that should trigger application of the market impact factor, the SEC reviewed historical flow information for institutional money market funds over a nearly five-year period (December 2016 to October 2021) and found that institutional funds had daily outflows greater than 4 percent on approximately 5 percent of trading days. According to the Release, this means approximately 3 out of the 53 institutional funds (as of October 2021) would have outflows exceeding this threshold *on "an average trading day*." Release at 193. This would mean that, on any trading day, some funds would be required to estimate market impacts even though the SEC found that "funds rarely experience large net redemptions that have significant market impact that would dilute investors." *Id*. Based on this analysis, we question why the SEC is proposing a market impact threshold that funds (especially funds with multiple NAV strikes per day) would exceed on trading days with no indication of market stress or disruption in underlying markets that would raise concerns regarding potential market impacts.

market impact of selling a vertical slice of a fund's portfolio to satisfy the amount of net redemptions for the pricing period.[26]

1.2.2 Swing Pricing Fails to Reflect How Money Market Funds Are Managed

The SEC theorizes that by externalizing the costs of redemptions, swing pricing would reduce or eliminate the first mover advantage for redeeming investors or dilution for investors remaining in the fund. Not only is the SEC's view merely a theory that does not have any empirical support, its rationale for swing pricing fails to appreciate that money market funds are designed to manage investor flows without causing stress on the funds or their remaining investors.

Money market funds handle large and frequent investor redemptions easily with minimal transaction costs. Indeed, the SEC acknowledges that a swing pricing requirement would not impose significant additional price volatility under normal market conditions because many institutional funds already use bid prices when valuing their portfolio investments and, thus, would not need to make additional price adjustments to reflect spread costs.[27] We agree. Although spread costs are a component of overall transaction costs, because most funds already use bid prices, we believe that the proposed swing pricing framework would have a negligible anti-dilution impact. Therefore, it is neither necessary nor appropriate or supported by any evidence.

Institutional money market funds typically hold substantial amounts of short- and near-term assets to meet regular and predictable—and potentially high—levels of outflows (especially at month and quarter end). For example, it is quite common for such funds to experience double digit net redemptions in the morning as institutional investors

[26] The fund would estimate market impacts for each security in its portfolio by first estimating the market impact factor. This factor is the percentage decline in the value of the security if it were sold, per dollar of the amount of the security that would be sold, under current market conditions. Then, the fund would multiply the market impact factor by the dollar amount of the security that would be sold if the fund sold a *pro rata* amount of each security in its portfolio to meet the net redemptions for the pricing period. Recognizing that it may be difficult to produce timely, good faith estimates of the market impact of selling a *pro rata* portion of each instrument the fund holds, the proposal would permit a fund to estimate costs and the market impact factor for each type of security with the same or substantially similar characteristics and apply those estimates to all securities of that type in the fund's portfolio, rather than analyze each security separately. The Release notes that it would be reasonable to apply a market impact factor of zero to the fund's daily and weekly liquid assets.

[27] The bid price is the highest price a buyer is willing to pay for a security or asset. The difference between the bid price and ask price is known as the market's spread and is a measure of liquidity in that security. US generally accepted accounting principles ("US GAAP") provide that the use of bid prices to value asset positions is permitted but not required. In contrast, mid-market pricing values a security at the average of its bid price and ask price. Since a seller generally asks for a higher price for a security than a buyer bids for that security, the mid-market price is incrementally higher than the bid price for a security, but lower than its ask price.

redeem their shares early to meet *their* daily or near-term cash needs, including for operating cash, to make quarterly corporate tax payments, or to meet payroll or other expenses. In contrast, investors often wait until the end of the day to subscribe to a fund as a way to maximize the time they have to determine their cash needs for that day.

Institutional prime money market funds anticipate this activity and build liquidity to meet these flows through observations of historical flow patterns and regular client interactions. Even for large unanticipated redemptions, funds meet these redemptions out of their daily and weekly liquid assets, and longer dated assets are sold in a manner (typically at bid) that does not incur market impact costs.

In addition, portfolio managers can meet redemptions by allowing their short-term portfolio assets to mature, rather than transacting in the secondary market. Applying swing pricing to *all* net redemptions by assuming the sale of a vertical slice of the portfolio—rigid requirements not imposed under the Rule 22c-1 swing pricing provisions for long-term mutual funds—simply does not comport with the assets of these funds and how advisers manage liquidity and therefore would not provide a reasonable approximation of the transaction costs associated with redemptions.

Indeed, the SEC provides no support for its conclusion that when daily net redemptions exceed 4 percent—the market impact threshold—"most funds may experience significant market impact if they were to sell a *pro-rata* share of their portfolio holdings to meet redemptions."[28] To the extent that this calculation methodology overstates the actual transaction costs associated with redemptions, redeeming shareholders would be subsidizing remaining shareholders—a result antithetical to the SEC's investor protection aims.

We also question whether it is possible to calculate (or make a good faith estimate of) the market impact of selling a vertical slice of a fund's portfolio in the secondary market. Under normal market conditions, secondary market trading in money market instruments, such as commercial paper, is limited because these securities, being short-dated, generally mature quickly, obviating the need to sell them to raise cash. Determining market impact is particularly challenging for securities that do not trade frequently, and the difficulty is exacerbated in times of stress such as March 2020 when markets froze and "good faith" estimates to determine market impact would have been meaningless.

It is noteworthy that the SEC is now proposing market impact costs as a component of the swing factor *despite previously rejecting this component in its final 2016 swing*

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[28] Release at 219-220.

pricing amendments for long-term mutual funds.[29] Among other things, ICI's 2016 comment letter pointed out that "estimating market impact costs *a priori* is very difficult, and requires judgments in which some fund managers may not have a high degree of confidence."[30] In its 2016 adopting release for these amendments, the SEC explained its rejection of market impact costs as follows:

> "In light of concerns that many funds may not be able to readily estimate market impact costs, as well as concerns that subjective estimates of market impact costs could grant excessive discretion in the determination of a swing factor, we have eliminated the consideration of market impact costs in setting the swing factor under the final rule."[31]

The SEC's reasons for eliminating market impact costs in 2016 are even more relevant for institutional money market funds. As noted above, getting accurate prices for a vertical slice of a money market fund's portfolio, especially during a time of market stress, is always challenging given the dearth of secondary trading in the short-term funding markets. Also, this is not how liquidity is managed in a money market fund. This all makes a market impact factor even less appropriate and more absurd for a money market fund than it was for long-term mutual funds when the SEC rejected the idea in 2016.

The SEC has offered no explanation or basis for changing its mind and taking a contradictory position today.

1.2.3 Swing Pricing Would Not Discourage Redemptions During Periods of Stress

ICI does not believe that the use of swing pricing by money market funds would have meaningfully reduced redemption activity during March 2020. By mid-March 2020, after problems had already appeared in the US Treasury bond market, the short-term funding markets, including the markets for municipal debt, commercial paper, and bank CDs, came under sharp stress as corporations and other investors "dashed for cash" to

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[29] Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, SEC Release No. IC-31835 (September 22, 2015) (2016 SEC Swing Pricing Release), available at https://www.sec.gov/rules/proposed/2015/33-9922.pdf. Specifically, proposed Rule 22c-1(a)(3)(i)(D)(1) would have required that the determination of the swing factor take into account "[a]ny near-term costs expected to be incurred by the fund as a result of net purchases or net redemptions that occur on the day the swing factor is used to adjust the fund's net asset value per share, including any market impact costs."

[30] Letter from David W. Blass, General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, Securities and Exchange Commission (January 13, 2016) at 66, available at www.sec.gov/comments/s7-16-15/s71615-54.pdf.

[31] Investment Company Swing Pricing, SEC Release No IC-32316 (October 13, 2016)("2016 Swing Pricing Release") at 75, available at https://www.sec.gov/rules/final/2016/33-10234.pdf.

reduce risk and hoard cash in the face of great economic uncertainty (even fear) resulting from the health crisis. Liquidity dried up, short-and long-term credit markets ceased to function, and the flow of credit to the economy evaporated. These dynamics affected *all* market participants and each part of the financial system, not only the non-bank sector. Importantly, money market funds did not cause the stresses in the short-term funding markets in March 2020.[32]

As noted above, the SEC's 2014 amendments that linked potentially high liquidity fees or gates to the 30 percent weekly liquid asset threshold created a tripwire for investors that made these funds even more susceptible to financial market stress in March 2020. Swing pricing would *not* have changed investor behavior, as downward adjustments to the share price—even if sizeable, for example 2 percent—are not likely to meaningfully deter shareholders seeking liquidity. In fact, the SEC's own staff did not find a correlation between market prices and institutional prime fund redemptions during March 2020.[33]

The SEC has failed to explain or offer other evidence for rejecting its own staff's findings.

1.2.4 Swing Pricing Would Eliminate Important Money Market Fund Features

Although the SEC acknowledges that swing pricing will introduce new operational complexity to institutional money market funds, it greatly underestimates these complexities, their costs, and the likely deleterious effect swing pricing would have on the continued viability of these funds for investors.[34]

To successfully implement swing pricing, a fund needs timely and reasonably accurate daily (or period-specific) fund flow information before calculating and publishing the fund's NAV. Without it, the fund would be unable to determine with certainty whether it has net redemptions—and net redemptions exceeding the applicable market impact threshold—for a given period. The SEC notes that a fund may estimate shareholder flow

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[32] For a detailed discussion of ICI's research of the March 2020 events and the role of money market funds, *see* 2021 ICI Letter to PWG, *supra* note 5, at Section 4; 2020 ICI Money Market Fund Report, *supra* note 6.

[33] Release at note 48.

[34] The Release notes that a fund must determine whether it has net redemptions, and the size of those net redemptions, for the pricing period prior to striking its NAV, and this determination would need to be completed multiple times per day for funds with multiple daily NAV strikes. In contrast to other mutual funds, however, the SEC believes that because money market funds often impose order cut-off times that ensure that they receive flow data prior to striking their NAV, they would have the necessary flow information to determine if there were net redemptions and the amount of those net redemptions. The SEC further believes that a T+1 settlement is not a likely result of the proposed swing pricing requirement because the funds could take steps to maintain their ability to offer same-day settlement if they believe this type of settlement is important to institutional investors (*e.g.*, moving the last NAV strike to an earlier point in the day, or reducing the number of NAV strikes per day).

information to determine whether the fund has net redemptions for a pricing period and to determine the amount of net redemptions provided the swing pricing administrator[35] receives sufficient investor flow information to make a reasonable estimate.

Estimating flows, however, is complicated if a fund needs to obtain fund flow information from intermediaries, such as broker-dealers, platforms, and portals, that generate much of the funds' order volume and fund flow activity.[36] In the Release, the SEC's treatment of this matter is merely cursory, suggesting that the SEC did not seriously consider this matter in preparing the proposal.

Even more concerning is the Release's failure to address what would constitute a NAV pricing error in light of the operational challenges and informational limitations that funds would face in performing swing pricing. With respect to errors, the 2016 Swing Pricing Release addressed the issue and stated that

> "as long as the fund has followed reasonable practices, policies and procedures in gathering sufficient information in determining whether net investor flows (which may include reasonable estimates) have exceeded the applicable threshold used for swing pricing, such differences [i.e., in actual versus estimated net flows] would not in and of itself result in a determination of a NAV pricing error requiring reprocessing of transactions or a financial statement adjustment to the fund's NAV."[37]

This Release contains no similar assurances.

Swing pricing is particularly challenging for institutional money market funds that include key features, such as pricing multiple times per day and same-day (T+0) settlement.[38] These features allow money market fund investors to sell shares and receive the proceeds from their redemptions on the same day, often within hours. This in turn allows corporations, government entities, not-for-profits, and other institutional

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[35] "Swing pricing administrator" is defined as the fund's investment adviser, officer, or officers responsible for administering the swing pricing policies and procedures. The swing pricing administrator may consist of a group of persons. The administration of the swing pricing program must be reasonably segregated from portfolio management of the fund and may not include portfolio managers.

[36] For a discussion regarding how the industry distribution model in the United States and the use of intermediaries complicates the use of swing pricing, *see* Investment Company Institute, "Evaluating Swing Pricing: Operational Considerations," (November 2016) (2016 ICI Swing Pricing Paper), available at www.ici.org/pdf/ppr_16_evaluating_swing_pricing.pdf.

[37] *Id*. at 110.

[38] Although some money market funds provide T+1 settlement, these funds are typically designed for retail investors.

investors to effectively and efficiently manage their day-to-day operating cash, meet payroll and other liabilities, and maintain appropriate levels of liquidity on a daily basis. Forcing funds to sacrifice these features to make swing pricing work fundamentally changes the nature of the funds and their utility to investors.

Rule 22c-1(a) under the Investment Company Act requires funds and dealers in fund shares to transact fund shares at the NAV next computed after receipt of an order to buy or redeem. In calculating a fund's NAV, the fund manager follows established, board-approved valuation policies and procedures.[39] Institutional prime money market funds typically settle T+0, which requires a fund to compute its NAV, receive and process redemptions, and complete Fedwire instructions after the fund's closing time (typically 4:00 pm ET) but before the Federal Reserve's 6:45 pm ET Fedwire cutoff time. Moreover, many institutional prime money market funds perform this process multiple times each day and offer T+0 settlement to help their institutional investors with their daily cash management needs.

The NAV calculation process for all floating NAV funds is largely similar.[40] Before the finalization of each NAV strike, the fund accountant (which can be the fund manager or a different service provider) transmits a file listing the fund's portfolio investments to a pricing vendor. The vendor inserts the current market price for each investment into the file and transmits it to the fund accountant. The fund accountant then applies a series of controls to validate the prices received. After researching and resolving any exceptions generated by the controls, the fund accountant uses the reviewed prices (and adjustments thereto, as necessary) to value the fund's investments and calculate its NAV. The NAV is then used to process orders and is disseminated through a variety of methods to the fund's transfer agent, intermediary distribution partners, media outlets, and investors.

Institutional money market funds would face even more daunting challenges if they were required to incorporate swing pricing into the process for calculating multiple NAVs throughout the day. Receipt of investor flow information is fundamental to determining first whether the fund has net redemptions for a pricing period, and if so, whether they exceed the applicable market impact threshold. It is unlikely a money market fund could gather this information prior to, or during, the NAV calculation process and still have sufficient time to calculate, apply, and potentially correct the application of a swing pricing mechanism multiple times each day and/or still accommodate same-day settlement *and* meet the Federal Reserve's current Fedwire

[39] For a discussion regarding the US NAV calculation and dissemination process, *see* 2016 ICI Swing Pricing Paper, *supra* note 36, at 5-6.

[40] Retail prime, retail tax-exempt, and government money market funds have two NAVs: the stable $1.00 NAV that uses amortized cost and penny rounding and the shadow NAV that uses mark-to-market prices. The shadow NAV is calculated at least daily.

6:45 pm ET cutoff time. The process is further complicated and meaningfully delayed when intermediaries generate any of the fund's order volume and fund flow activity; in that case, the *fund would need to depend on its intermediaries to deliver the flow information in a timely and reliable manner*. It is doubtful that many intermediaries could deliver the order flow information as promptly as would be needed.

In sum, to accommodate the operational challenges of swing pricing, money market funds would need to impose earlier order cutoff times on investors; reduce the number of daily NAV strikes; pay redemption proceeds in a less timely way; and receive flow information from intermediaries earlier in the day or period. These changes would greatly disrupt investors' ability to manage their cash flow and daily liquidity (because it would likely eliminate important features such as multiple NAV strikes and same-day settlement) and funds' ability to compel more timely flow information from intermediaries without incurring significant additional costs is far from certain.

We also note that even if funds could accommodate the operational challenges of swing pricing, only the largest funds would likely survive because the costs would be substantial and prohibitive for smaller funds. We do not believe the SEC should want to create a regulatory environment that dampens competition and accelerates further industry consolidation.

1.2.5 Tax Implications

The SEC recognizes, as discussed in the Release, that the SEC staff will need to discuss with the staff of the Treasury Department and Internal Revenue Service (IRS) the tax consequences of the proposed swing pricing requirement. The potential tax implications mentioned in the Release include the consequences of an investor using the NAV method of accounting for gain or loss on floating NAV money market fund shares and the exemption from the wash sale rules for redemptions from these funds. Fund investors could be burdened, the SEC acknowledges, if current tax treatment is modified by the proposed swing pricing requirement.

We agree with the SEC that close coordination with the Treasury Department and the IRS is needed to ensure that appropriate tax guidance is issued *before* any SEC rule on swing pricing takes effect. Potential issues, in addition to those mentioned in the Release, could include the tax consequences to the fund and ultimately fund investors of any amounts retained pursuant to the swing price mechanism.

1.2.6 Accounting Implications

Accounting considerations also may arise from swing pricing. We note that the SEC, working with other regulators, should minimize the potential differences between tax treatment and accounting treatment when possible to curtail complexity and potential shareholder confusion.[41]

US GAAP currently includes investments in money market funds as one of three examples of a "cash equivalent" (along with Treasury bills and commercial paper).[42] Treating money market fund shares as cash equivalents is important to fund investors because, among other things, the investors may have debt covenants that require them to maintain certain levels of cash and cash equivalents. An increase in cash equivalents equals higher liquidity. A company with higher liquidity ratios generally is considered healthier and poses less of a risk. If corporate investments in money market funds are not cash equivalents, they would instead be considered investment securities held for trading purposes under US GAAP. It is therefore imperative that any future money market funds reforms not preclude shareholders from classifying their investments in money market funds as cash equivalents for purposes of US GAAP.

1.2.7 Nonpublic Institutional Prime Money Market Funds Do Not Need Special Provisions

Nonpublic institutional prime money market funds typically are organized by a fund adviser for the purpose of managing the cash of other investment companies in a fund complex and operate in almost all respects as a registered money market fund, except that their securities are privately offered and thus not registered under the Securities Act of 1933. Nonpublic institutional prime money market funds are a valuable tool for investment companies because they are designed to accommodate the daily inflows and outflows of cash of the investment companies and typically can be operated at a lower cost than publicly offered money market funds.

Because nonpublic institutional prime money market funds generally are created for investment by investment companies with the same sponsor, they naturally have greater visibility into upcoming redemptions, leaving little concern for unforeseeable

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[41] Consistent with the approach the SEC established for mutual fund swing pricing in 2016, the proposed swing pricing requirement for institutional money market funds would affect certain aspects of financial reporting, as these funds would need to distinguish between the US GAAP NAV per share and the transactional price adjustment to the NAV per share resulting from swing pricing. Swing pricing also affects disclosure of capital share transactions included in a fund's statement of changes in net assets and a money market fund using swing pricing would be required to disclose certain items in a footnote to its financial statements.

[42] US GAAP defines cash equivalents as short-term, highly liquid investments that are both (i) readily convertible to known amounts of cash, and (ii) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Generally, only investments with original maturities of three months or less qualify under that definition. Original maturity for this purpose means original maturity to the entity holding the investment.

large-scale redemptions or runs. These funds also have the ability to set up conflict processes and procedures to mitigate any potential first mover advantage.

Given the nature and purpose of nonpublic institutional prime money market funds, it is not surprising that these funds had redemptions of only 3 percent of assets during the week of March 20, and lost approximately 6 percent of their total assets ($17 billion) from March 9 through March 20.[43] These outflows were even lower than retail prime funds (11 percent of their total assets ($48 billion)).[44] Moreover, according to Form N-MFP data, retail prime and nonpublic institutional prime money market funds did not sell more relatively longer-term portfolio securities (*i.e.*, securities that mature in more than a month) in March 2020 relative to their typical averages.

Therefore, the case for imposing swing pricing on nonpublic institutional prime money market funds has not been established and is especially weak—they, like retail money market funds, do not need a special mandatory ADM as demonstrated by their *lower* levels of redemptions in periods of stress. To this end, absent evidence, the SEC must exempt nonpublic institutional money market funds from any mandatory ADM.

1.2.8 Fee Alternative for Public Institutional Money Market Funds

As noted above, we believe removing the tie between the 30 percent weekly liquid asset requirement and the possibility of an immediate gate, or less concerning, a 2 percent fee, as well as increasing the minimum liquidity levels addresses the challenges money market funds experienced in 2020. Additional reforms, especially ones that will fundamentally alter the product and its appeal to investors, are neither supported by the data nor necessary.

If the SEC nevertheless can convincingly demonstrate, based on data and analysis (including that provided through this comment process) and not just conjecture, that an ADM is necessary for public institutional prime and institutional tax-exempt money market funds (and we believe that the SEC has failed to do so to date), we believe modifying and leveraging the existing fee framework would be a less problematic approach. [45] An appropriately designed fee (without the possibility of a gate) that does not repeat the mistakes of the 2014 amendments could serve the goals the SEC is seeking to solve through swing pricing and avoid imposing unnecessary operational costs across the industry. We note that other regulatory bodies and policymakers have

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[43] Release at 15.

[44] *Id*.

[45] In connection with the SEC's 2014 money market fund amendments, an ICI industry working group developed a document intended to outline common communications protocols related to applying or removing (or, in the case of a liquidity fee, revising) a liquidity fee or redemption gate, for use by money market funds with intermediary partners.

recognized fees as an ADM, particularly given the challenges of swing pricing in certain jurisdictions, including the United States.[46]

At a high level, swing pricing is based on the presumption that redemptions are typically met by asset sales. The purpose of calculating a swing factor is to estimate the transaction costs associated with those asset sales. For money market funds, however, where redemptions are met through cash on hand using a fund's non-dilutive daily liquid assets, this presumption is inaccurate and, in application, may unduly harm redeeming investors.

A well-designed fee that reflects actual market conditions and investor behavior in a money market fund could impose direct and transparent costs[47] on redeeming investors (without providing a discount to subscribing investors) during times of severe stress and could be less likely to contribute to preemptive redemptions in future stress periods.[48]

Criteria for an ADM: First, as the name implies, an ADM should operate only when redemptions are likely to materially dilute the remaining shareholders of an institutional money market fund. As demonstrated in Figure 1 above, a prime money market fund can use daily and weekly liquid assets to cover double-digit redemptions for weeks on end without incurring costs that might dilute the interests of remaining shareholders.[49] Raising weekly liquid assets to 40 percent and daily liquid assets to 20 percent will further increase the level of redemptions institutional funds could absorb without risking dilution. Any ADM should be limited to circumstances consistent with a level of redemptions likely to require sales of longer-term assets, which would be well above the proposed market impact threshold of 4 percent.

Second, to prevent an ADM from providing an incentive to redeem and potentially encourage runs, shareholders should not be able to anticipate when the ADM would take effect. This is difficult given how transparent money market funds have become,

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[46] *See* Financial Stability Board, *Policy Proposals to Enhance Money Market Fund Resilience*, Final Report (October 11, 2021) (FSB Report); European Securities and Market Authority, Final Report—ESMA Opinion on the Review of the Money Market Fund Regulation (February 14, 2022).

[47] In contrast, investors have little insight into the amount of a swing factor or when it would be applied. In fact, the proposal does not contemplate a cap on the swing factor.

[48] In 2016, the SEC intentionally excluded money market funds from its swing pricing rule, explaining that money market funds already have extensive tools at their disposal that could accomplish comparable goals to swing pricing, such as liquidity requirements that are more extensive than those imposed on other funds. *See* 2016 SEC Swing Pricing Release, *supra* note 29, at 24-25. The SEC also noted that unlike other types of open-end funds, money market fund investors are "particularly sensitive to price volatility." *Id*. To this end, the SEC believe that "liquidity fees would be used only in times of stress when money market funds' internal liquidity has been partially depleted." *Id*.

[49] Tax-exempt institutional funds, which maintain weekly liquid assets much higher than the required 30 percent can sustain even larger redemptions without risking dilution to their remaining shareholders.

with daily reporting of flows and daily and weekly liquid assets. Using large net redemptions as an ADM trigger would be difficult for shareholders to anticipate, as flows are reported the next day and regularly fluctuate between net subscriptions and redemptions. Therefore, an appropriately calibrated net redemption test could work as a single trigger. If calibrated incorrectly, however, large net redemptions could introduce the risk of false positives since funds routinely expect and prepare for large redemptions by increasing their daily liquid assets. In this circumstance, large redemptions would not result in any dilution that the ADM would need to address.

Weekly liquid asset levels may provide a more reliable indication of an increased risk of dilution. Shareholders can easily monitor weekly liquid assets, however, and thereby anticipate an increased risk of an ADM. Although removing the risk of gating may make some shareholders less sensitive to reductions in reported weekly liquid assets, a weekly liquid asset trigger for an ADM may still prompt some shareholders to redeem preemptively to avoid the ADM. To mitigate this risk, any weekly liquid asset level that would trigger an ADM should be substantially below the level required by Rule 2a-7. This also would give institutional money market funds leeway to use weekly liquid assets for their intended purpose: to buffer the fund and short-term funding markets from the impact of net redemptions.

Third, to be fair to shareholders, any ADM should be triggered only in response to actual fund-specific stress and consider the short tenors of money market fund holdings and the fundamental nature of these funds as cash management vehicles. For example, a 1 percent discount on a 60-day security, which is the longest average maturity permitted by Rule 2a-7 and consistent with the WAL of prime money market fund holdings, produces an annualized yield of about 6 percent above the security's current yield. It would require extreme market conditions to produce this result.

Given these criteria, ICI members believe that a properly calibrated fee (with a cap) could be a more appropriate ADM for certain institutional money market funds without the high costs and complexity of applying a swing factor.[50] Potential fee alternatives to swing pricing for public institutional prime and institutional tax-exempt money market funds include the following.[51]

Discretionary fees: The SEC could develop a liquidity fee framework that would require a fund's board of directors to consider certain specified factors when determining whether to implement a liquidity fee (*e.g.*, up to 1 percent) subject to a determination

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[50] The recommendations for fee alternatives in this portion of the letter apply *only* to public institutional prime and institutional tax-exempt money market funds. These funds differ significantly from other types of money market funds and long-term mutual funds with respect to investment strategies, portfolio holdings and characteristics, historical redemption patterns, composition of shareholder base, distribution channels, and applicable regulatory requirements.

[51] Members also will submit comment letters discussing their individual views on specific fee alternatives.

that implementing fees is in the best interests of the fund and fund shareholders and is necessary to prevent material dilution or other unfair results. A discretionary approach, based upon specific auditable procedures, would give fund boards the discretion to assess the current market conditions and determine a fee that best approximates the actual cost of liquidity. A discretionary fee approach would avoid the pitfalls of the current liquidity fee approach and make it very difficult for shareholders to anticipate when a liquidity fee will take effect, thus avoiding serving as a new bright line trigger. Fund boards would, similar to responsibilities currently entrusted to them under Rule 2a-7 with regard to pricing and valuation, have the fiduciary responsibility to apply a fee based on a fund's specific circumstances and in the best interest of shareholders.

Mandated fees: The SEC could develop a liquidity fee framework that would be automatically triggered based on a set of predetermined criteria—ideally using two triggers. The first trigger would be based on net redemptions (which may be difficult to anticipate) and the second trigger based on liquidity levels (which may be anticipated, but necessary to ensure there is truly stress in the market).

- *First Trigger—Net redemptions*. Members generally agree that sustained and abnormally large net redemptions can be used as a proxy for the stress that redemptions place on a specific money market fund. Of note, the SEC also recognized the importance of net redemptions in calibrating its proposed swing pricing requirement. As discussed above in Section 1.2.2, however, the 4 percent market impact threshold requirement is clearly too low because it fails to reflect how money market funds are managed. Particularly for multi-strike NAV funds, where that amount is further subdivided, a net redemption of 4 percent is not unusual for a money market fund during normal market times and is easily met using a fund's daily liquid assets. Many members believe 10 percent net redemptions per day, half of the 20 percent daily liquid asset requirement we proposed in Section 1.3, is more indicative of potential market stress. Although funds can experience high levels of redemption activity in normal market conditions due to routine, expected flow activity, when coupled with a second trigger, as discussed below, members believe the risk of false positives is reduced at a 10 percent level.

- *Second Trigger—Liquidity levels*. As discussed above, money market funds can meet even very large redemptions during normal market times. Adding a liquid asset test would ensure that there is truly stress in the fund. We note that the SEC might be wary of incorporating a liquid asset trigger given the defects of the current liquidity fee requirement. Based on the experience of certain money market funds in March 2020, however, the bigger concern for investors was the possible imposition of gates, and to a lesser extent, an immediate 2 percent fee if a fund had dropped below 30 percent.

Nevertheless, members believe there may be ways to add a liquidity trigger that would reduce the risk of investors in these money market funds seeking to avoid the fee by redeeming ahead of the trigger.

For example, one approach would be to use the levels indicative of a liquidity threshold event. Under the SEC's proposal, a liquidity threshold event occurs when a money market fund's liquidity has decreased more than 50 percent below at least one of the proposed minimum daily and weekly liquid asset requirements. Members generally believe that a decrease of 50 percent of required liquidity can potentially indicate stress in the portfolio. This framework also would allow money market funds to use half of their liquidity buffers as an extra source of liquidity in times of stress. Under this framework, a static fee, such as 1 percent, would be applied to redeeming investors in these money market funds if the dual trigger is met.

Rather than a static fee, another approach would be to adopt tiered redemption fees. Under this approach, for example, assuming the SEC increases weekly liquid assets to 40 percent, a small fee (*e.g.*, 0.25 percent) could be imposed if the fund's weekly liquid assets drop below 30 percent. A larger fee (*e.g.*, 1 percent) could be imposed if a fund's weekly liquid assets drop below 20 percent and an even larger fee (*e.g.*, 2 percent) could be imposed if a fund's weekly liquid assets drop below 10 percent. Having tiered weekly liquid asset level triggers would impose incremental costs on redeeming investors before the fund is in severe stress. The tiering also could help mitigate the "cliff risk" associated with using a weekly liquid asset level as it may reassure investors that only a small fee would be assessed in the highest tier.

Currently, Rule 2a-7 requires a liquidity fee only after a fund's weekly liquid assets have been reduced to 10 percent and only if the fund's board of directors (including a majority of independent directors) have not determined that the liquidity fee is not in the best interest of the fund. Any of the mandatory fee frameworks discussed above would therefore substantially increase the measures an institutional prime or tax-exempt money fund must take in response to redemptions that significantly deplete its liquidity. Such measures, if the need is convincingly substantiated, should be more than enough to address any lingering concerns the SEC may harbor regarding the dilutive effects of redemptions on remaining shareholders.

1.3 Amendments to Portfolio Liquidity Requirements

The SEC is proposing to increase daily and weekly liquid asset requirements to 25 percent and 50 percent, respectively.[52] With the exception of tax-exempt money market

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[52] The Release notes that the largest weekly outflow in March 2020 was around 55 percent, and the largest daily outflow was about 26 percent (both well above the respective weekly liquid asset and daily liquid asset thresholds of 30 percent and 10 percent).

funds, which will continue to be exempt from the daily liquid asset requirements, the SEC's proposal does not establish different liquidity thresholds by type of fund.

Although we generally support an increase in portfolio liquidity requirements, a more modest increase is appropriate because changes to the current fee and gate framework would allow fund managers to more freely use existing liquid assets to meet redemptions.

In addition to specific minimum daily and weekly liquid assets, money market funds must maintain sufficient liquidity to meet reasonably foreseeable investor redemptions, as well as other commitments it has made to investors. As a complement to these requirements, the SEC also imposes a requirement that money market funds adopt "know your customer" policies and procedures to assure that funds undertake appropriate efforts to identify risk characteristics of their investors and to plan their holdings of liquid assets accordingly.

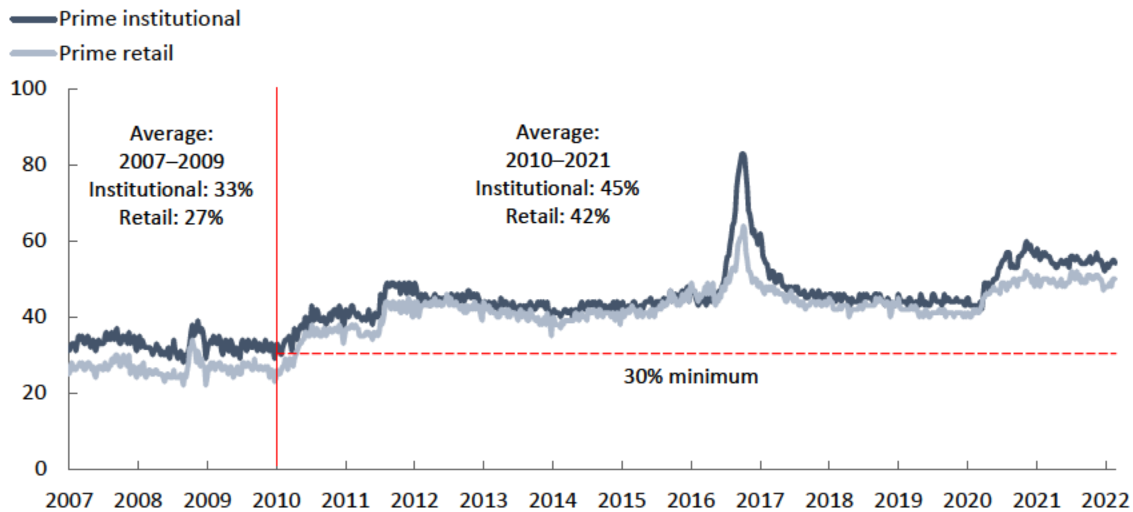
Not surprisingly, since 2010 (when the SEC first added the liquidity requirements to Rule 2a-7), prime money market funds' weekly liquid assets (as a percentage of their portfolios) have exceeded the 30 percent minimum by a significant margin—on average by 12 to 15 percentage points—illustrating that these funds operate conservatively (Figure 2).

As noted above in Section 1.1, at the height of the crisis and after weeks of market turmoil and before the Federal Reserve announced the creation of the MMLF, institutional prime money market funds, though faced with significant redemptions, still had plentiful liquidity levels that would have been sufficient to weather a severe liquidity event had they been able to access this liquidity without triggering investors' fear of facing a gate.

FIGURE 2

Prime Money Market Funds Are More Liquid After the Global Financial Crisis

Average weekly liquid assets of prime money market funds, percentage of fund assets, weekly, January 2, 2007–February 22, 2022



Note: The large spike in weekly liquid assets from roughly June 2016 to May 2017 reflects prime money market funds transitioning their portfolios ahead of the SEC's October 2016 deadline for institutional prime money market funds to use floating NAVs. Prime money market funds, especially institutional funds, expected to (and did) see large outflows as investors shifted to government money market funds. Averages for 2010–2021 exclude observations from June 2016 to May 2017.
Source: 2020 ICI Money Market Fund Report, *supra* note 6.

Although the Release suggests that the proposed liquidity buffers are generally consistent with the average liquidity levels prime money market funds have maintained over the past several years, our data show these levels are slightly lower. According to ICI data, from 2010 to 2021, institutional prime money market funds on average held 45 percent of their assets in weekly liquid assets, and retail prime money market funds held on average 42 percent of their assets in weekly liquid assets—exceeding the 30 percent threshold by significant margins and illustrating that these funds seek to operate with substantial liquidity on hand in the normal course of business.

Therefore, a modest increase in the portfolio liquidity requirements—consistent with what most public prime money market funds already maintain as a matter of conservative liquidity risk management—could make these funds more resilient, especially since research demonstrates that the current liquidity levels (*i.e.*, 30 percent weekly liquid assets coupled with know your customer requirements) would have been sufficient to weather a severe liquidity event had money market funds been able to access this liquidity. To this end, we recommend the SEC increase daily and weekly liquid asset requirements to 20 percent and 40 percent, respectively. As our earlier simulation results show, at a 40 percent level, and in the absence of the potential for redemption gates, institutional prime money market funds would likely have had plentiful liquidity even in the face of very large, sustained outflows (16 percent per week).

Increases that are too high could materially affect the ability of money market funds to serve as direct sources of financing for businesses and financial institutions. Indeed, in determining the appropriate level of weekly and daily liquid assets for money market funds, the SEC should consider the potential adverse effects on issuers of CP and CDs. One problem noted by the President's Working Group was that, during the second week of March 2020, CP issuance "shifted to short tenors. For instance, the share of CP issuance with overnight maturity climbed steadily to nearly 90 percent on March 23."[53] Shorter tenors increase an issuer's funding risk, as a larger portion of its working capital must be refunded each day. This increase in refunding can increase the impact of disruptions in the short-term funding market on these issuers. Increases in weekly and daily liquid asset requirements would force money market funds to lend at shorter tenors and may thereby increase the vulnerability of issuers to market disruptions.

Increases that are too high also would make it difficult (or impossible) to continue to attract investors by providing a return that is above that of a public debt money market fund, such as a US Treasury or government money market fund.

Board notification. The proposed rule would require a fund to notify its board of directors of a liquidity threshold event, that is, when the fund has invested less than 25 percent of its total assets in weekly liquid assets or less than 12.5 percent of its total assets in daily liquid assets. The proposal would require a fund to notify the board within one business day of the liquidity threshold event and provide a brief description of the facts and circumstances that led to the liquidity threshold event within four business days after its occurrence.

As a matter of course, most money market fund boards are typically notified when their liquidity levels approach the liquidity minimums. We therefore generally support a requirement that would require a fund to notify its board upon a liquidity threshold event, provided the definition of such event is adjusted to require board notification when daily liquid assets and weekly liquid assets go below 10 percent and 20 percent, respectively (half of our proposed liquidity levels).

1.4 Proposed Amendments to Liquidity Metrics in Stress Testing

Each money market fund is currently required to engage in periodic stress testing under Rule 2a-7 and report the results of such testing to its board. Currently, one aspect of

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[53] Request for Comment on Potential Money Market Fund Reform Measures in President's Working Group Report*,* SEC Release No. IC-34188 (February 4, 2021), available at www.sec.gov/rules/other/2021/ic-34188.pdf, at 11. The Report is appended to the SEC's release and also is available on the Treasury Department's website at home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf.

periodic stress testing involves the fund's ability to have invested at least 10 percent of its total net assets in weekly liquid assets under specified hypothetical events described in Rule 2a-7. Because the SEC's proposal would no longer provide for default liquidity fees if a fund has weekly liquid assets below 10 percent, and the proposal would increase the weekly liquid asset minimum from 30 percent to 50 percent, the SEC no longer believes that the rule should require funds to test their ability to maintain 10 percent weekly liquid assets under the specified hypothetical events described in Rule 2a-7.

Instead, the SEC is proposing to require funds to test whether they are able to maintain sufficient minimum liquidity under such specified hypothetical events. As a result, each fund would be required to determine the minimum level of liquidity it seeks to maintain during stress periods, identify that liquidity level in its written stress testing procedures, periodically test its ability to maintain such liquidity, and provide the fund's board with a report on the results of the testing. We support this more principles-based approach to stress testing.

1.5 Amendments Related to Potential Negative Interest Rates

The Release notes that twice during the past 15 years the Federal Reserve established the lower bound of the target range for the federal funds rate at 0 percent. The Release further notes that government and retail money market funds can maintain a stable share price while investing in instruments that yield a low but positive interest rate, but, if interest rates and the gross yield of a fund's portfolio turn negative, it would be challenging or impossible for the fund to maintain a stable share price.

Rule 2a-7, in its current form, does not explicitly address how money market funds must operate when interest rates are negative. Rather, Rule 2a-7 states that government and retail money market funds may seek to maintain a stable share price by using amortized cost and/or penny-rounding accounting methods, requiring that a fund may only use those methods so long as the fund's board of directors believes that the stable share price fairly reflects the fund's market-based NAV per share.

In addition to the pricing provision described above, Rule 2a-7 also includes certain procedural standards for stable NAV funds that require that the fund periodically calculate the market-based value of the portfolio ("shadow price") and compare it to the fund's stable share price. If the deviation between these two values exceeds ½ of 1 percent (50 basis points), the fund's board of directors must consider what action, if any, should be taken by the board, including whether to re-price the fund's securities above or below the fund's $1.00 share price (*i.e.*, "break the buck"). Regardless of the extent of the deviation, Rule 2a-7 imposes on the board of a money market fund a duty to consider appropriate action whenever the board believes the extent of any deviation may result in material dilution or other unfair results to investors or current shareholders.

Since 2010, Rule 2a-7 also requires stable NAV money market funds and their transfer agents to have the capacity to redeem and sell securities at prices that do not correspond to a stable price per share.

1.5.1 Financial Intermediaries

Although the SEC is not proposing changes to the Rule 2a-7 pricing provisions in relation to negative interest rates, it is proposing to expand government and retail money market funds' obligations to confirm that they can fulfill shareholder transactions if they convert to a floating share price. Specifically, the SEC proposes to require a government or retail money market fund (or the fund's principal underwriter or transfer agent on its behalf) to determine that financial intermediaries that submit orders—including through an agent—to purchase or redeem the fund's shares have the capacity to redeem and sell the fund's shares at prices that do not correspond to a stable price per share or, if this determination cannot be made, to prohibit the relevant financial intermediaries from purchasing the fund's shares in nominee name. Funds would have the flexibility in how they make this determination for each financial intermediary but would be required to maintain records identifying the intermediaries the fund has determined have the capacity to transact at non-stable share prices and the intermediaries for which the fund was unable to make this determination.

We strongly oppose a requirement that government and retail money market funds must determine that each financial intermediary has the capacity to redeem and sell securities issued by a fund at a floating NAV per share or prohibit the financial intermediary from purchasing the fund's shares in nominee name. Although it may be desirable for financial intermediary platforms to be capable of processing transactions in a government or retail money market fund's shares at a price other than $1.00 *if* the fund converts to a floating NAV, we do not believe that mandating this capability is necessary for many reasons. First, imposing this requirement on government and retail money market funds is not necessary or relevant to the redemption pressures experienced by other money market funds in March 2020, which is the focus of this rulemaking. Unlike public institutional prime and institutional tax-exempt money market funds, government and retail money market funds did not experience large redemptions. Indeed, government money market funds, which serve as a vehicle of choice during periods of stress, attracted substantial flows in March 2020.[54]

Second, the costs of implementing this requirement would be prohibitively expensive for many financial intermediaries. Currently, certain financial intermediary platforms cannot accommodate transacting in government and retail money market fund shares at a price other than $1.00 per share. Most notably, many platforms for cash sweep and bank-like services, including ATM access, check writing, and ACH and Fedwire transfers,

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[54] See 2020 ICI Money Market Fund Report, *supra* note 6, 12-13.

operate on a “dollar in, dollar out” infrastructure that does not accommodate a floating share price because they are designed to facilitate enormous volumes of money market fund transactions that automatically “sweep” cash in and out of the funds in connection with customer sale and purchase transactions. Although other types of financial intermediary platforms and accounts may offer floating NAV money market funds, they are built on an entirely different infrastructure and typically require an affirmative purchase or sale instruction rather than an automated “sweep” or transaction process. It is our understanding that changing the infrastructure to accommodate a floating NAV per share in a sweep platform would impose a significant cost on financial intermediaries—a cost, given the current economic environment, many financial intermediaries may be unwilling to bear.

If financial intermediaries do not change the systems underlying these sweep platforms and other similar platforms that rely on a stable value money market fund, government and retail money market funds may not receive the proposed assurances or certifications from those financial intermediaries. Without such an assurance, a financial intermediary is not eligible to offer shares of government or retail money market funds. Since financial intermediaries generate a significant portion of these funds order volume and activity, it is highly likely that the rule proposal would cause assets in these funds—*including government money market funds*—to fall drastically. This consequence, which the SEC does not seem to have anticipated, could have very significant effects on the economy at large.

First, businesses could lose access to a very safe liquidity management tool, notably government money market funds. Second, retail investors whose brokerage firms use these funds as a sweep product would likely be forced into bank deposit account sweeps, whose yields have historically lagged behind yields on money market funds, depriving retail investors of extra income. Third, issuers who borrow from money market funds, including the US Treasury and government sponsored enterprises (GSEs), would see an important funding source dry up. Fourth, as assets in money market funds—including government money market funds—fall sharply, investors’ dollars will naturally shift to banks. In the case of businesses, large amounts of their assets could flow to bank demand deposit accounts, which could have implications for monetary policy (*e.g*., through influences on banks’ reserve balances at the Federal Reserve). We urge the SEC to discuss with the US Treasury, the Federal Reserve, and the GSEs the consequences of seeing trillions of dollars flow out of money market funds before proceeding down this path.

Finally, irrespective of a financial intermediary’s systems, government and retail money market funds currently are free to operate with a floating share price under Rule 2a-7. The SEC does not need to adopt a new provision in Rule 2a-7 that uses government and retail money market funds as a stick to enforce the behavior of financial intermediaries. Money market funds regularly work with financial intermediaries to accommodate the needs of various types of investors and, if a government or retail money market fund determines to convert to a floating share price, the fund could work with intermediaries to implement the change at that time. Some financial intermediaries may already have the capacity to accommodate a floating NAV money market fund automatically, whereas other intermediaries may need to manually process such transactions. In addition, certain industry participants already have developed systems to operate RDM for government and retail money market funds. A negative interest rate environment, if it were to occur at all,[55] and absent less costly and disruptive alternatives (such as RDM), would likely take time to degrade a government or retail money market fund's market-based NAV per share, providing an opportunity for money market funds and financial intermediaries to determine the appropriate response at such time, depending on the capabilities of the financial intermediaries to accommodate a floating NAV.

For the reasons set forth above, we strongly oppose a requirement that a government or retail money market fund (or the fund's principal underwriter or transfer agent on its behalf) determine that financial intermediaries that submit orders—including through an agent—to purchase or redeem the fund's shares have the capacity to redeem and sell the fund's shares at prices that do not correspond to a stable price per share or, if this determination cannot be made, to prohibit the relevant financial intermediaries from purchasing the fund's shares in nominee name.

If the SEC nevertheless believes it is necessary to proceed with some form of this aspect of the proposal, the SEC should only do so after (i) engaging in further discussions with the government and retail money market fund industry (which represents over $4 trillion in assets under management and 88 percent of the overall money market fund assets—well beyond the assets of institutional prime and institutional tax-exempt money market funds, which are the focus of this rulemaking) and (ii) conducting a thorough cost-benefit analysis, taking into account the actual costs of implementing the changes to systems and infrastructure to accommodate a floating NAV per share on financial intermediary platforms and the impact to government and retail money market funds and their investors, and perhaps most importantly to the possibility of shifting trillions of dollars from one sector of the short-term funding markets to another (*e.g.*, to banks).

In addition, if the SEC believes it is necessary to proceed with some form of this aspect of the proposal, the SEC should reduce the burden on government and retail money

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[55] We note that it is highly unlikely that a government or retail money market fund would be forced to float its NAV per share due to negative interest rates. Since the SEC initially adopted Rule 2a-7, the United States has not experienced a period of negative interest rates. Indeed, as the Release notes, some policymakers at the Federal Reserve have expressed views that negative interest rates do not appear to be an attractive monetary policy tool in the United States. This is especially true in the current economic environment where the Federal Reserve is now considering increases in the federal funds rate to combat inflation.

market funds. Some government and retail money market funds may offer their shares through hundreds of intermediaries and this requirement would be administratively challenging and costly to implement for the funds. Entering into new, or amending existing, agreements is a time-consuming and expensive exercise. Instead of requiring this determination, the SEC could allow a money market fund to disclose that, in a negative interest rate environment, the fund may need to transact at a price other than $1.00 and, as a condition of transacting in fund shares the financial intermediary would be responsible for transacting its customers' transactions at a floating NAV per share or otherwise have plans to move its customers to accounts that would accommodate a floating NAV per share.

1.5.2 Reverse Distribution Mechanism

Due to concerns regarding the potential misleading or confusing nature of a RDM, the SEC is proposing to amend Rule 2a-7 to prohibit money market funds from operating an RDM, routine reverse stock split, or other device that would periodically reduce the number of the fund's outstanding shares to maintain a stable share price. We strongly oppose this prohibition.

An RDM is a mechanism by which a government or retail money market fund, through its transfer agent, could reduce the shares of the fund in an amount equal to the negative accrual each day to cover negative yields. These negative distributions would be allocated to shareholders on a *pro rata* basis.[56] As a practical matter, the effect of an RDM to a shareholder would be economically identical to the conversion to a floating NAV per share. This is because the reduction in the number of shares held by a shareholder in a government or retail money market fund that uses RDM would be equal to the reduction in the market-based NAV per share held by a shareholder in a floating NAV money market fund caused by its realization of negative net income. In other words, the effect of RDM would be to simply incorporate a stable NAV money market fund's realization of negative net income that would otherwise be reflected in the market-based NAV per share of a similarly situated floating NAV money market fund.

All things being equal, some investors, especially retail investors, may prefer a stable NAV per share with a reduction in the number of shares through RDM over a money market fund with a floating NAV per share. In particular, a floating NAV would reduce the value and convenience of money market funds to individual retail investors. For example, brokers and fund sponsors typically offer investors a range of features tied to their money market funds, including bank-like services with ATM access, check writing, and ACH and Fedwire transfers. These features are generally only provided through

[56] Similar to RDM, a reverse stock split would reduce the number of shares in an investor's account in order for the fund to maintain a stable share price.

systems designed for stable NAV products. As noted above, the stable NAV also enables the processing of cash balances through cash sweep programs, in which all customer cash balances are "swept" into investments in shares of money market funds that are owned by the customers but transacted through fund accounts registered to a broker-dealer or a bank. Sweep programs cannot typically accommodate floating NAVs.

We also note that RDM was used successfully in Europe following the 2008 global financial crisis and ensuing sovereign debt crisis, when the European Central Bank began pursuing a negative interest rate policy. We are not aware of any issues raised by European money market fund shareholders that invested in money market funds that used RDM and it is our understanding that those shareholders preferred this mechanism over a floating NAV per share.[57]

In the Release, the SEC stated its belief that, if negative interest rates turn a stable NAV fund's gross yield negative, the board may reasonably believe the stable share price does not fairly reflect the market-based price per share, as the fund would be unable to generate sufficient income to support a stable share price. The Release explains that, under these circumstances, the fund would not be permitted to use amortized cost and/or penny-rounding accounting methods to seek to maintain a stable share price and the fund would need to convert to a floating share price. The SEC further stated its belief that, if interest rates turn negative, the board of a stable NAV money market fund could reasonably require the fund to convert to a floating share price to prevent material dilution or other unfair results to investors or current shareholders. We disagree and believe that a board of a stable NAV money market fund could decide to employ an RDM or reverse stock split in a negative interest rate environment, because those tools are not inconsistent with Rule 2a-7.

Under Rule 2a-7, a government money market fund or retail money market fund is permitted to maintain a stable NAV per share by using the amortized cost method and/or the penny-rounding method to calculate the current share price for purposes of distribution and redemption. To use these methods, the board of such a fund must determine that it is in the best interests of the fund and its shareholders to maintain a stable NAV per share. Moreover, Rule 2a-7 requires a stable NAV money market fund to determine the shadow price and calculate the extent of the deviation from the fund's stable share price. If such deviation exceeds ½ of 1 percent (50 basis points), the board must consider what action, if any, should be taken. The board of a stable NAV money market fund also is required to cause the fund to take action to prevent material dilution or other unfair results to investors or existing shareholders if it believes the extent of any deviation between the fund's shadow price and stable price will result in such material dilution or unfair results. Notably, Rule 2a-7 does not dictate what action

[57] RDM is no longer available in Europe following regulatory changes completely unrelated to the effectiveness of RDM.

a board may or may not take to address the deviation in the fund's shadow price or prevent such dilution of interests. Rather, Rule 2a-7 gives fund boards the flexibility to determine what action will be in the best interest of shareholders.

We further note that the SEC staff has acknowledged in FAQ guidance that a reverse stock split may be used to increase or stabilize the NAV per share of a stable NAV money market fund:

> **Q. If a stable NAV money market fund engages in a reverse stock split in order to increase or stabilize its NAV per share, might such action be reportable on Form N-CR?**
>
> **A.** Yes. Part D of Form N-CR requires a stable NAV money market fund to file a report if its current NAV per share deviates downward from its intended stable price per share by more than ¼ of 1 percent. The staff understands that a reverse stock split could in effect mask what might otherwise be a significant deviation in the price per share. Accordingly, if such a fund would have experienced a deviation of more than ¼ of 1 percent but for the reverse stock split, the staff believes such deviation should still be disclosed on Part D, calculated as if the reverse stock split had not occurred.[58]

This guidance indicates that a reverse stock split would not conflict with (and is not required to be excluded from) the board's finding that the stable NAV per share continues to "fairly reflect" the market-based NAV per share. And as noted above, certain industry participants already have developed processes and systems to operate RDM for government and retail money market funds.

We believe that the board of a stable NAV fund should retain the authority to determine, in good faith and using its reasonable business judgement, that implementing an RDM or reverse stock split is in the best interest of the fund and its shareholders to address a deviation in the fund's shadow price and to prevent a material dilution of interests in the fund to existing shareholders. Rule 2a-7 currently grants boards that authority and boards should continue to be able to decide what action it deems appropriate to address a deviation greater than ½ of 1 percent in the fund's shadow price or to prevent dilution of interests. The board of a stable NAV money market fund may reasonably determine that implementing an RDM or reverse stock split in a negative yield environment would result in better outcomes for investors than converting to a floating NAV or liquidating. For example, a board may recognize

[58] SEC Division of Investment Management, 2014 Money Market Fund Reform Frequently Asked Questions (revised February 7, 2019), Question No. 11.

that converting to a floating NAV fund could eliminate key benefits for its retail investors.[59]

Also, a negative interest rate environment could be a short-term phenomenon. If a stable NAV money market fund were required to transition to a floating NAV, and then interest rates quickly returned to positive levels, the fund would likely switch back to a stable NAV per share. This transition back and forth between floating and stable NAVs could be challenging for funds to implement and ultimately more confusing to investors than an RDM or reverse stock split.

Notably, a negative interest rate environment (if it should ever occur in the United States) would not only affect stable NAV money market funds, but also other short-term cash management products. If interest rates turn negative, investors would likely also be faced with charges on bank deposit accounts and other effects associated with holding their cash, to the extent that those investors would even be able to maintain large deposit accounts with banks in such an environment. To these investors, a stable NAV money market fund using an RDM may be preferable to other alternatives. We believe that removing this type of investor choice for a future hypothetical event is unnecessary at this time.

The Release states that the SEC believes an RDM would not be intuitive for investors in retail and government money market funds to understand, as investors will observe a fund holding a stable share price while their investment loses value over time due to the reduction of the number of shares held. The Release notes that European money market funds that used RDM successfully are typically only held by institutional investors, whereas money market funds in the United States have a mix of retail and institutional investors.

We do not believe that RDM or reverse stock splits would confuse investors, and, in any event, we believe that proper, plain-English, disclosure can adequately inform investors of the possibility and mechanics of RDM or a reverse stock split. A money market fund could provide this disclosure to shareholders prior to, and at the time, RDM is used to alert investors. In addition to registration statement disclosures, money market funds could inform and educate investors with website and other disclosures. Investments in money market funds are mostly offered through intermediaries who also would be able to assist investors in understanding the mechanics of RDM or a reverse stock split. We believe that investors are likely to pay more attention to the balance in their account

[59] We also note that a floating NAV would introduce tax reporting issues for retail investors, s*ee* 2021 ICI Letter to PWG, *supra* note 5, at 36-37. To reduce investor harm, the tax impact to a shareholder transacting in shares of a stable NAV fund using RDM should be comparable to that of a shareholder transacting in shares of a floating NAV fund. Before a fund uses RDM, guidance from the Internal Revenue Service would be needed to confirm this treatment and address any other tax considerations.

rather than the price per share, so they will not be confused that the value of their investment has gone down. As noted above, a negative interest rate environment likely would not impact only money market funds—investors would likely be losing money on other short-term cash management products, including floating NAV money market funds, as well as deposit accounts that could assess fees in a negative interest rate environment and other short-term investments.

Finally, similar to the points noted above with respect to financial intermediaries, imposing this type of requirement on government and retail money market funds is unnecessary because it is very unlikely that the United States will experience negative interest rates, the costs of requiring stable NAV money market funds to float is prohibitively expensive, and stable NAV money market funds were not subject to redemption pressures in March 2020, which is the focus of this rulemaking.

Removing options like RDM and reverse stock splits from a money market fund's and its financial intermediaries' and shareholders' options would eliminate a tool that could be used in a negative interest rate environment, limit investor choice for programs offered with stable NAVs, and potentially impact monetary policy as large amounts of assets shift to banks. RDM and reverse stock splits should be permitted to preserve many investors' preference for a stable NAV investment. Based on feedback from our members, it is our understanding that certain intermediaries and investors—in particular, many sweep and other platforms—prefer to invest in stable NAV money market funds rather than floating NAV money market funds. As such, the proposed provision to prohibit RDM or reverse stock splits should not be included in the final amendments.

1.6 Amendments to Specify the Calculation of WAM and WAL

The SEC is proposing to amend Rule 2a-7 to specify the calculation of WAM and WAL. The SEC has found that funds use different approaches when calculating WAM and WAL under the current definitions in the rule. For instance, the SEC understands that a majority of money market funds calculate WAM and WAL based on the percentage of each security's market value in the portfolio, while other money market funds base calculations on the amortized cost of each portfolio security. This discrepancy can create inconsistency of WAM and WAL calculations across funds, including in data reported to the SEC and provided on fund websites.

Accordingly, the SEC is proposing to require that money market funds calculate WAM and WAL based on the percentage of each security's market value in the portfolio because all types of money market funds already determine the market values of their portfolio holdings for other purposes, while only certain money market funds use amortized cost. Thus, the SEC believes all money market funds can use this calculation approach with information they already obtain. The Release notes that these amendments will enhance the consistency of calculations for funds, while allowing the

SEC to better monitor and respond to indicators of potential risk and stress in the market.

We agree and support these amendments.

1.7 Amendments to Reporting Requirements

ICI consistently has supported efforts to increase the public disclosure of money market fund portfolio information and risks, and enhance the SEC's access to money market fund data. In 2009, the MMWG Report recommended that money market funds reassess their risk disclosures, and provide more transparency into the holdings of money market fund portfolios.[60] In 2010 and again in 2014, the SEC dramatically increased both the amount and frequency of disclosures required by money market funds, making them one of the most transparent financial products in the United States. The SEC is now proposing certain reporting requirements on Forms N-CR and N-MFP to improve its ability to monitor money market funds, including the facts and circumstances of any liquidity threshold event (*i.e*., when a fund falls below a minimum liquidity requirement), new information about a fund's shareholders, and disposition of non-maturing portfolio investments, as well as to make certain conforming changes to Form N-1A to reflect the proposed changes to the regulatory framework. Our comments on specific aspects of the SEC's proposed amendments are discussed below.

1.7.1 Form N-CR

The SEC is proposing to add a new requirement for a money market fund to file a report on Form N-CR when a liquidity threshold event occurs. Currently, money market funds are required to provide information about the size of their weekly liquid assets and daily liquid assets on a daily basis on their websites. The SEC believes this new requirement would help investors, the SEC and its staff monitor significant declines in liquidity, without having to monitor each money market fund's website. Although we understand the SEC's desire to monitor significant declines in liquidity and to gain more insight into a fund's short-term and immediate liquidity profile, we are concerned that public reporting of this information may affect investor behavior and act as a trigger leading to preemptive redemptions. Drops in liquidity are not necessarily indicative of widespread systemic issues. Rather, they may be short-lived, isolated, or caused by idiosyncratic events not relating to general market stress. As such, we believe such reports should be filed confidentially (and remain confidential) with the SEC. As the Release notes, investors can already see liquidity levels on funds' public websites and Form N-CR may increase investor sensitivity to liquidity levels.

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[60] *See* 2009 MMWG Report, *supra* note 5, at 91-93.

1.7.2 Form N-MFP

Form N-MFP is the form that money market funds use to report their portfolio holdings and other key information each month. The SEC uses the information on Form N-MFP to monitor money market funds and support its examination and regulatory programs. The SEC is proposing to add certain new information about a fund's shareholders and disposition of non-maturing portfolio investments, as well as other changes to enhance the accuracy and consistency of information funds currently report, to increase the frequency of certain data points, and to improve identifying information for the reporting fund. A money market fund is currently required to file its Form N-MFP within five business days after the end of each month. Given the sheer volume of new information and the increase frequency of certain data points, five business days is insufficient time to prepare the necessary filing. As such, we urge the SEC to extend the filing period to seven business days.

1.7.2.1 Class-Level Information About the Fund

Among other things, the proposed amendments would require all money market funds provide the name and percent of ownership of each person who owns of record or is known by the fund to own beneficially 5 percent or more of the shares outstanding in the relevant class. Although money market funds currently provide substantially the same information on an annual basis in their registration statements,[61] we question how naming a fund's investors who own 5 percent or more of its outstanding shares on a monthly basis would meaningfully help the SEC administer its regulatory program. We believe such disclosures should respect the privacy expectations of investors. To this end, we note that proposed changes to Form PF (which is a confidential filing) would require large liquidity fund advisers to provide only the type of investor and amount owned for each investor that beneficially owns over 5 percent of the fund's equity.[62]

1.7.2.2 Schedule of Portfolio Securities

For purposes of reporting the fund's schedule of portfolio securities in Part C of Form N-MFP, the SEC is proposing that filers provide required information separately for the initial acquisition of a security and any subsequent acquisitions of the security (*i.e.*, for each lot). We have concerns with this level of disclosure.

For example, the SEC is proposing an additional item that would require funds to provide the trade date on which the security was acquired and the yield of the security as of that trade date. The Release explains that this information is intended to assist the

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[61] *See* Item 18 of Form N-1A.

[62] *See* Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers, SEC Release No. No. IA-5950 (January 26, 2022), available at https://www.sec.gov/rules/proposed/2022/ia-5950.pdf, at Question 59.

SEC in understanding how long a fund has held a given position and the maturity of the position when it was first acquired. The Release further notes that this information is important to understand a money market fund's portfolio turnover during normal market conditions and to monitor a potentially higher level of asset disposition during periods of market stress. Members have expressed concern that publicly disclosing lot level yield information could allow predatory traders to reverse engineer a fund's trading strategies. To this end, if the SEC still believes this information is crucial to its examination and regulatory programs, we request that the information collected be kept confidential.

The proposal also would remove the ability for funds to aggregate certain required information if multiple securities of an issuer are subject to a repurchase agreement. The Release notes that removing this provision would provide more complete information about securities subject to a repurchase agreement. Members have expressed concern about the sheer volume of additional reporting—hundreds of additional rows of data. Beyond the statement about how removing the provision would provide "more complete" information, the SEC does not explain the benefit of this additional work. We therefore urge the SEC to retain the ability for funds to aggregate this information.

2. Compliance Dates

If adopted as proposed, removal of the liquidity fee and redemption gate provisions and related disclosure requirements would be effective when the final rule is effective. The SEC proposes a 12-month compliance period for swing pricing (and related disclosures) and amendments related to potential negative interest rates and a 6-month compliance period for all other aspects of the proposal, including increased daily and weekly liquid assets and amendments to Form N-CR and Form N-MFP.

One year is not sufficient for the industry to develop, test, and implement all the necessary changes to various systems to accommodate swing pricing. One year also is not sufficient for intermediaries to build the capacity to transition stable NAV funds to floating during a negative interest rate environment. This conclusion is supported by our discussions with members, intermediaries, and vendors that support industry processing.

Instead, the SEC should provide at least 24-months following issuance of final SEC rules to allow the industry to complete the broad client service and operational requirements necessary to successfully implement any new reforms that will dramatically change the industry.

A 12-month compliance period, rather than 6 months, also is necessary to transition to any increased liquidity requirements and the new reporting requirements which, in terms of increased reporting frequency and additional data points, constitute a significant implementation effort.

3. PWG Report Reform Options

We support the SEC's decision not to include other reform options discussed in the PWG Report, such as minimum balance at risk, capital buffers, and liquidity exchange bank membership. These policy options would not advance the SEC's goals of reform and would not preserve the key characteristics of money market funds beneficial to the financial system and the broader economy. Specifically, such options have significant drawbacks, ranging from detrimental impacts on money market funds, their investors, and the markets to complicated (and costly) regulatory, structural, and operational barriers to implement. The likeliest impact of any of these options would be to decrease the utility and attractiveness of these products to investors and cause fund sponsors to exit the industry.[63]

Conclusion

ICI and its members appreciate the opportunity to comment on the SEC's proposed amendments. We are committed to working with the SEC to further strengthen money market funds' resilience to severe market stress. If you have any questions, feel free to contact me at [redacted]

Sincerely,

/s/ Eric J. Pan

Eric J. Pan
President & CEO

cc: Gary Gensler, Chair, Securities and Exchange Commission
Hester M. Peirce, Commissioner, Securities and Exchange Commission
Allison Herren Lee, Commissioner, Securities and Exchange Commission
Caroline A. Crenshaw, Commissioner, Securities and Exchange Commission

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[63] For a discussion of ICI's position on these reforms, *see* 2021 ICI Letter to FSB, *supra* note 5 (MBR (Section 3.3.1), capital buffers (Section 3.3.2), and liquidity exchange bank membership (Section 3.3.2.1)).