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Previous Reform Made Prime Funds Less Resilient This Time Around

By Shelly Antoniewicz

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Even as the market turmoil triggered by strict government mandates and social distancing due to the COVID-19 health crisis raged in March 2020, ICI started studying how registered funds [weathered the crisis](#). As the dust settled, we quickly identified a key factor that exacerbated outflows for some prime money market funds: the regulatory tie between a fund maintaining 30 percent of its assets as “liquid” (with remaining maturities of a week or less) and the trigger for a fee or gate to halt or slow redemptions. This connection made investors more likely to redeem as a prime money market fund’s weekly liquidity approached 35 percent. As a result, prime money market funds were more susceptible to financial market stress in March 2020—and would probably be again in future periods of stress if this connection remains.

Experiences of US Money Market Funds During the COVID-19 Crisis

That’s why ICI strongly supports a proposal to delink the tie between weekly liquid assets and the decision to impose fees or gates, one of 10 proposals made by the President’s Working Group on Financial Markets in its [report on money market funds](#) (PWG Report).

In ICI’s [letter](#) to the Securities and Exchange Commission regarding the PWG Report, we detail how the 30 percent weekly liquid asset threshold caused investors to redeem more heavily in March 2020 when a fund started approaching that level—a level that only had significance because of a regulatory bright line, and not because of any actual difficulties in the fund’s ability to meet redemptions.

Thus, the 30 percent threshold—established by the prior round of money market fund reform, in 2014—became a redemption trigger. It was a real-life example of the tail wagging the dog.

Our letter also includes new evidence that the main reason prime money market funds accessed the Federal Reserve’s Money Market Mutual Fund Liquidity Facility (MMLF) was to raise their weekly liquidity asset levels and keep them well above the 30 percent regulatory tripwire.

Prime Money Market Funds Made Modest Use of the MMLF

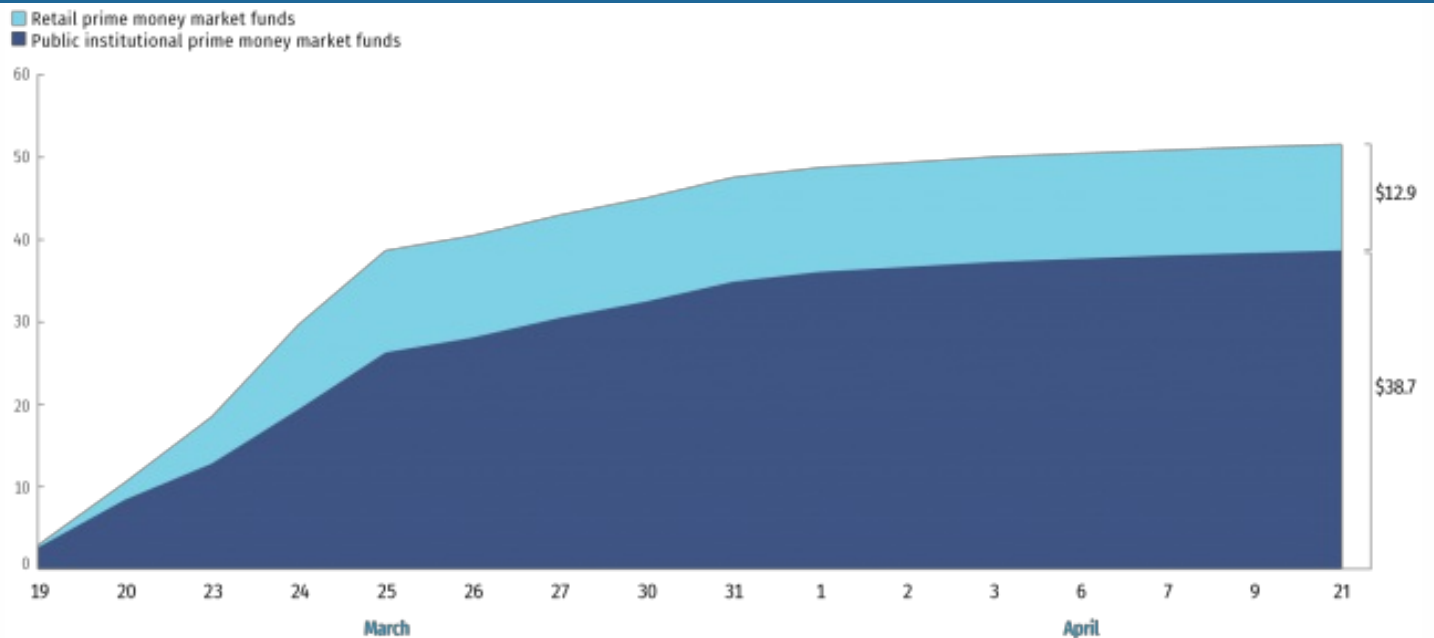
To help improve understanding of the events of March 2020, ICI Research conducted a survey of ICI’s members to gather detailed information on any assets that were ultimately pledged to the MMLF starting on March 19. Respondents represented 70 percent of the prime money market funds, and 95 percent of prime money market fund assets, as of February 2020.

The Fed announced the formation of the MMLF on March 18. Despite its name, the MMLF did not lend to money market funds directly, but rather provided financing to banks to buy commercial paper and other securities from prime money market funds. According to ICI’s survey, on March 19, public institutional and retail prime money market funds began selling eligible securities to

banks, which then pledged those securities as collateral to the MMLF.

By March 25, public institutional and retail prime money market funds had sold nearly \$40 billion in eligible securities that were ultimately pledged to the MMLF (Figure 1). As of April 21, the last date survey respondents reported selling eligible securities for the purpose of accessing the MMLF, 36 public institutional and retail prime money market funds had sold a cumulative total of \$51.6 billion in eligible securities that were earmarked for the MMLF. Public institutional prime money market funds sold \$38.7 billion and retail prime money market funds sold \$12.9 billion. Nonpublic institutional prime money market funds did not sell any eligible securities for the purpose of accessing the MMLF.

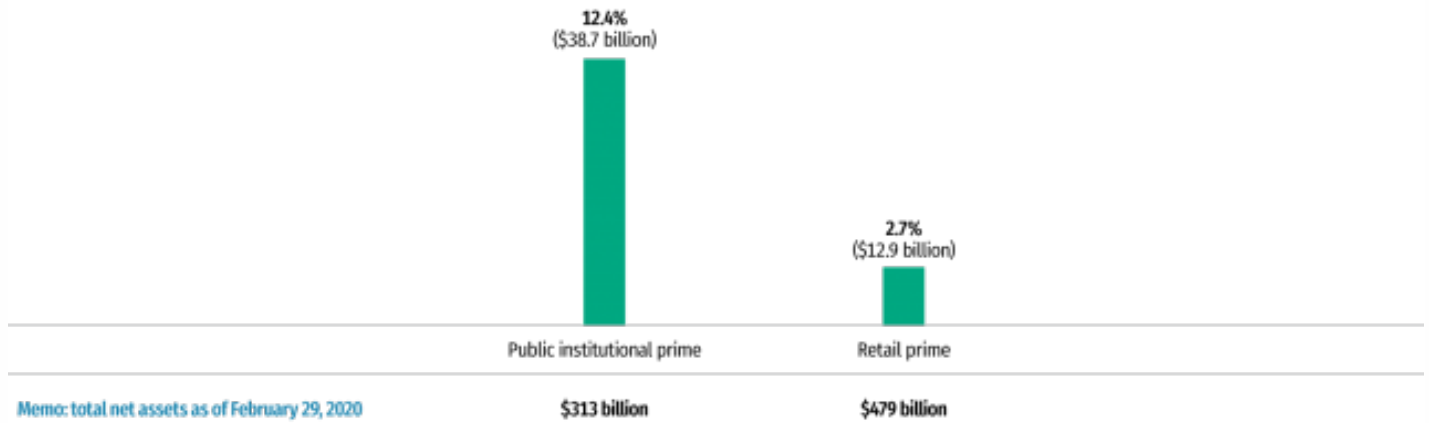
Figure 1
Prime Money Market Funds Drew Nearly \$52 Billion from the MMLF
Billions of dollars



Source: Investment Company Institute survey of prime money market funds

The total amounts drawn on the MMLF represented a small share of the assets of these funds: a little more than 12 percent of the assets of public institutional prime money market funds as of February 2020, and just less than 3 percent of the assets of retail prime money market funds (Figure 2). At its peak, the aggregate size of the MMLF was about one-third of the size of the analogous Federal Reserve facility used in the global financial crisis, which peaked at \$152 billion.

Figure 2
Use of the MMLF Was a Small Share of Prime Money Market Funds' Assets
Total drawn from the MMLF as a percentage of February 2020 month-end total net assets



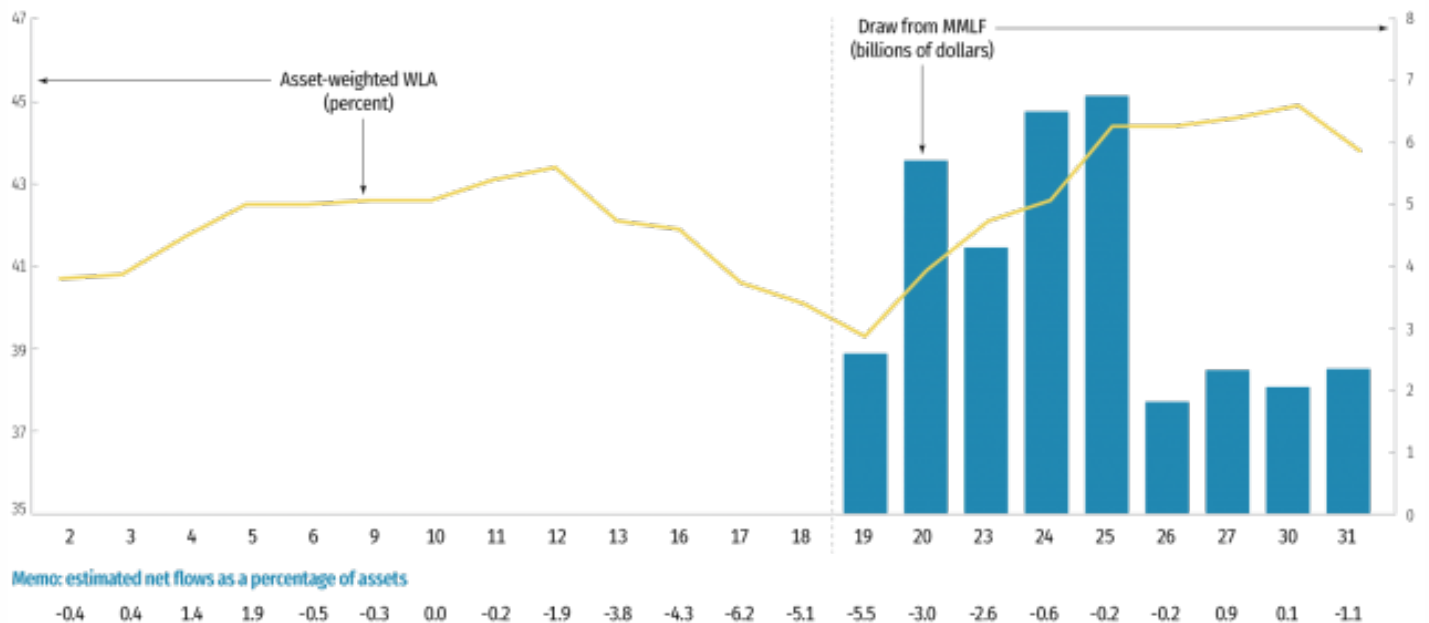
Source: Investment Company Institute

Use of MMLF Was Driven by the 30 Percent Tripwire

Respondents to ICI’s survey reported that a major factor for accessing the MMLF was to bolster their prime funds’ weekly liquid asset ratios—keeping them well above the 30 percent tripwire.

As redemption requests progressively increased, public institutional and retail prime money market funds began to deplete their weekly liquid assets. For the public institutional prime money market funds that used the MMLF, their asset-weighted weekly liquid asset ratio dropped from a peak of 43.4 percent on March 12 to 39.3 percent on March 19 (Figure 3).

Figure 3
The MMLF Helped Funds Keep Weekly Liquid Assets Well Above 30 Percent
 Public institutional prime money market funds that drew on the MMLF, daily, March 2020



Sources: Investment Company Institute, iMoneyNet, and Crane Data

After the MMLF became operational, prime money market funds’ weekly liquid asset ratios jumped quickly, even while the funds continued to experience outflows. Public institutional prime money market funds’ asset-weighted weekly liquid asset ratio rose to 44.4 percent on March 25.

Retail prime money market funds that used the MMLF experienced smaller outflows in both dollar terms and as a percentage of their assets. But they too saw a decline in their weekly liquid assets, from a peak of 40.6 percent on March 16 to 39.0 percent on March 19 (shown on page 55 in our [letter](#)). After they used the MMLF, their asset-weighted liquid asset ratio climbed back to 44.2 percent on March 25.

Untouchable Assets

Let's be clear: the prime money market funds that sold eligible securities to use the MMLF still had ample liquid assets to operate and meet redemptions. Unfortunately, 30 percent of their assets were untouchable because the weekly liquid asset threshold was tied to the potential imposition of fees or gates. Investors—particularly the sophisticated institutions using public institutional prime money market funds to manage their daily cash needs—were focused intently on their funds' weekly liquid asset ratios and redeemed more heavily from funds whose weekly liquid asset ratios dropped below 35 percent. Essentially, prime money market funds' floor on weekly liquid assets was more like 35 percent.

The regulatory tie between weekly liquid assets and the possible imposition of fees or gates made prime money market funds less resilient to investor redemptions and more dependent on market intermediaries. Those intermediaries were themselves facing deep challenges to buy any securities with more than a week remaining maturity from any investors, including funds, during the financial market stress in March. Only the Federal Reserve, as the lender of last resort, could unlock those frozen short-term funding markets.

See also [“On Closer Look, a Very Different Picture of Funds' Role in the Commercial Paper Market”](#)

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