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The Global Health Crisis – A real-life stress test of MMF reform

The market stresses experienced in March/April of 2020 were the result of an unprecedented Global Health Crisis the likes of which has not been seen since the Spanish flu over a hundred years earlier. It was not a financial crisis. The stresses experienced were the predictable and obvious result of chaotic and uncoordinated responses of governments around the world and their affirmative decisions to shut-down global economies. The disruptions were not caused by structural vulnerabilities in money market funds (MMFs). Conditions in the real world affected the markets, not the other way around. And the market impacts were felt first in equities and commodities, later in bond markets, then in money markets and finally in MMFs.

The only appropriate comparison of the Health Crisis with the 2007/09 Financial Crisis is the perpetuation of a false narrative that MMFs caused or exacerbated each crisis. Accepting this false narrative blindly allows policy makers to ignore the more complicated issues that need to be addressed to ensure that financial markets operate in a crisis. In a crisis, the implementation of emergency liquidity assistance to financial institutions is a core responsibility of central banks. They are the lenders of last resort. They serve this role, not to preserve MMFs, but to preserve liquidity and stability across markets. Whether central banks serve in this capacity once in 12 years, twice in 12 years, or 3 times in 100 is of no consequence – it is the role they are intended to serve when markets are placed under extreme pressure.

The real problem to be addressed is not MMFs, but the systemic illiquidity and seizing up of markets that are essential to financial stability**.** Many regulators fail to distinguish between systemic liquidity events and systemic credit events. This distinction is essential for understanding today's reform debate.

Global regulators are currently focused on potential MMF reforms included in the President's Working Group (PWG) Report. Most of the policy measures discussed in this report have been previously considered and rejected because they would negatively impact the viability of MMFs to the detriment of investors, issuers and the capital markets generally. However, one of the proposals does address the key issue which impacted MMFs in the Health Crisis – and that is the decoupling of the weekly liquid asset requirement from a necessity to consider the imposition of a fee or gate. This bright line trigger was adopted by global regulators, despite industry warnings, and served as a catalyst for investor redemptions. It should be removed.

We do, however, believe that a MMF's board should be permitted to impose liquidity fees or redemption gates when doing so is in the best interest of the fund and its investors to prevent unfair dilution, without reference to any specific level of liquidity. Additionally, we believe requirements to maintain minimum levels of liquidity and knowledge of one's investor base should remain, as they are appropriate and necessary safeguards for investors. The benefits of such requirements were evident throughout the Health Crisis.

The experience of MMFs throughout the Health Crisis should be applauded, as despite frozen markets and delayed central bank action, all MMFs were able to fully meet investor redemption requests. The Health Crisis was a real-life stress test of the global MMF reforms adopted after the Financial Crisis and demonstrated that MMFs were not only resilient, but that are instrumental to investors and markets and should be protected – not eliminated.

MMFs have been one of the most successful market innovations over the past 50 years. They improve market efficiency and stimulate competition by providing lower cost borrowing for issuers and higher returns for shareholders. Since 1985, MMFs alone have provided over Eur 500 billion more in incremental returns to investors than bank deposit accounts and over this whole period only two prime MMFs have "broken the buck" at no cost to taxpayers. Meanwhile thousands of banks have failed, costing depositors and taxpayers Eur billions.