FROM: Institutional Cash Distributors, LLC (ICD)

TO: Financial Stability Board (FSB)

RE: ICD's Response to FSB's 30 June 2021 Policy Proposals to Enhance Money Market Fund Resilience Consultation report

DATE: 16 August 2021

INTRODUCTION

Institutional Cash Distributors (ICD), LLC is headquartered in San Francisco with a UK-based entity, Institutional Cash Distributors, LTD, located in London. We service over $5 trillion in money market trades annually on our independent trading platform, ICD Portal, for more than 400 treasury organizations across 65 industries and 43 countries.

ICD sits between institutional investors and over 40 fund providers. In this capacity, ICD has offered comments to the Securities Exchange Commission in response to its Request for Comment on Potential Money Market Fund Reform Measures in the President's Working Group Report **(File No. S7-01-21)**, to the Financial Stability Board (FSB) and International Organization of Securities Commissions (IOSCO) during a 21 April 2021 Virtual Stakeholder Outreach Meeting on Enhancing the Resilience of Money Market Funds, and to ESMA in response to its Consultation Paper on the EU Money Market Fund Regulation – legislative review (29 March, 2021). Today, we are responding to the FSB's Consultation Report on Policy Proposals to Enhance Money Market Fund Resilience (30 June 2021), questions 1-3.

In short, ICD believes that the exit from prime money market funds (MMFs) in March 2020 was triggered by the concern over fees and gates, not from a fundamental flaw with the instruments themselves, and that funds perform worse where reforms have been enacted for eliminating stable NAV, as evidenced from trading in the U.S. and Europe on ICD Portal.

ICD'S RESPONSE TO OVERALL QUESTIONS 1-3:

1. What are the key vulnerabilities that MMF reforms should address? What characteristics and functions of the MMFs in your jurisdiction should be the focal point for reforms?

There are primarily two key vulnerabilities that reforms should address from a global perspective:

1.) the inability of fund providers to access the 30% weekly liquid assets (WLA) buffer to avoid triggering liquidity gates and fees, and

2.) the potential for significant redemptions from funds in the U.S. around mark-to-market disruptions causing temporary losses in funds in the U.S.

2. What policy options would be most effective in enhancing the resilience of MMFs, both within individual jurisdictions and globally, and in minimising the need for extraordinary official sector interventions in the future?

The most effective policy options would be those aiming to reduce or remove the direct tie of liquidity levels with fees and gates and avoid imposing variable NAV on these products. From a global perspective, we've seen significant differences in regulatory regimes in the U.S. and Europe with less direct ties to liquidity levels and a stable NAV having been helpful in reducing the overall magnitude of the redemptions.

Reducing or Removing the liquidity tie with fees/gates

When the commercial paper market seized in mid-March 2020 in the U.S., prime MMFs had ample liquidity to cover significant redemptions. As redemptions outpaced purchases, however, the weekly liquid assets (WLA) of some funds were heading towards 30%. Many of our clients decided to redeem their prime MMFs because they were concerned a gate would be imposed if weekly liquidity fell below 30%. From an early March high, our client average daily balance of U.S. prime assets on ICD Portal dropped 80% by the middle of that month. In Europe, where the fees and gates provision is less onerous, the outflows and asset rotation from our platform was not as significant, decreasing 30% over that same period. A more direct tying of fees and gates to 30% liquidity in the U.S. caused greater stress around the market liquidity crisis.

Further decoupling of regulatory thresholds from suspensions/gates would make it much easier for MMFs to tap into that liquidity buffer should they need to do so. If there are still concerns about liquidity, increasing liquidity buffers could help offset some of the concerns around the potential to drop below thresholds and enable funds to dip into those liquidity buffers more regularly.

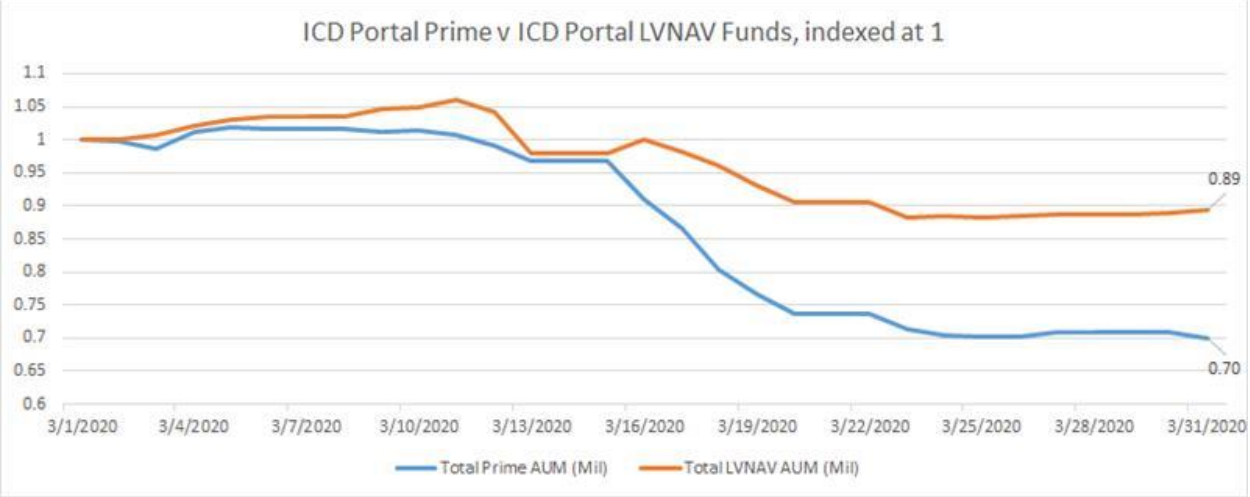
Avoid Imposing Variable NAV

Amending MMF regulation to eliminate stable NAV funds could have the unintended consequences, as we've seen in the U.S., of small losses due to temporary dislocation in mark-to-market valuation for investments designed to be held to maturity. It will potentially cause additional investor outflows, above and beyond what ordinarily would be expected with a stable NAV product that values itself at amortized cost. In addition, the unintended result of the proposal to switch from LVNAV to VNAV will result in significantly less utilization of the funds as we saw following the imposition of a floating NAV in the U.S. in October 2016.

If we look at evidence from the U.S., the comparative resilience of LVNAV funds can be seen both prior to reform and more recently in March 2020. According to Crane Data, a year prior to MMF reform (31 October 2015) prime fund assets hovered at $863 billion. Even at times when cash levels are at an all-time high, prime still tracks at more than 20% below the pre-reform period. As a result of reform mandates to switch to VNAV funds, prime assets have been reduced 22% to $676 billion, as of 31 May 2021, according to Crane Data's institutional prime money market fund index, diminishing this instrument as a useful investment tool for treasury groups.

Further evidence of the resilience of LVNAV can be seen from March 2020, when reforms were in place. From the period 1 March 2020 – 31 March 2020, ICD saw significantly more pronounced outflows of VNAV funds in the U.S. (30%) versus LVNAV funds (11%) in Europe [Figure 1].

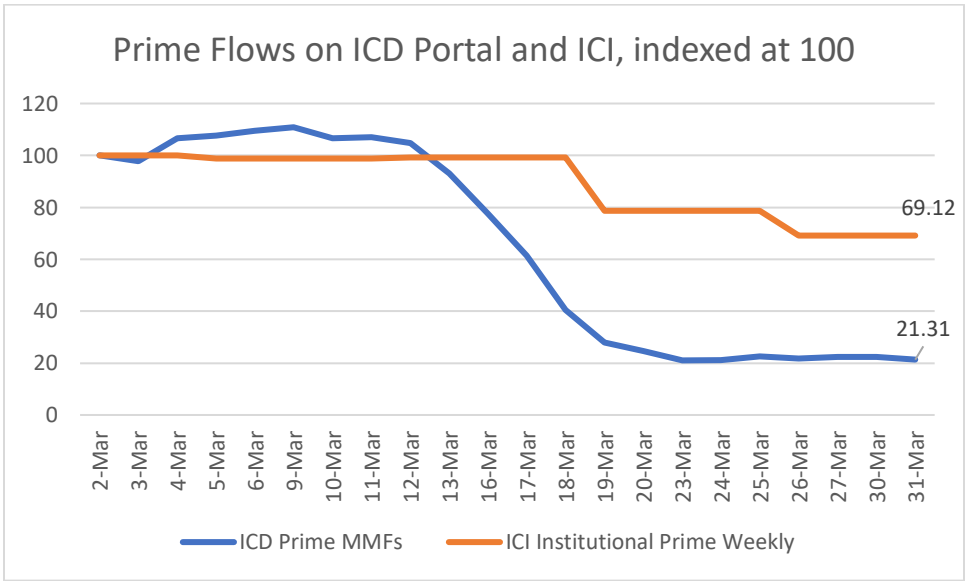
Figure 1.



Source: ICD Data

What we saw from both ICD client data and industry data overall was that the imposition of floating NAV in the U.S. exacerbated the "dash for cash" [Figure 2]. While it shifts the mark-to-market risk more directly to investors, it exacerbates mass redemptions by having minute and temporary dislocations in mark-to-market valuations translate into potential losses, causing investors to sell in larger numbers vs where the amortized cost methodology still exists.

Figure 2.



Sources: ICD Data; Investment Company Institute (ICI)

Removing LVNAV and mandating floating NAV would also make banks more systemically significant. VNAV funds would become more of an accounting burden to investors, who then would be moving money into bank deposits, further concentrating risk in that sector. In addition, investors may look to invest directly in securities themselves, potentially without the infrastructure in place to hold the securities or the expertise to assess the credit risk of a single issuer.

Diminishing the usefulness of MMFs as investment vehicles will also significantly restrict corporate funding options, having a downstream impact for smaller borrowers. As commercial paper accounts for a significant amount of underlying assets in MMFs, the impact of reducing corporate borrowing options will make large corporations more dependent on commercial banks for funding, which in turn would squeeze out smaller corporations who rely on these banks today.

3. How can the use of MMFs by investors for cash management purposes be reconciled with liquidity strains in underlying markets during times of stress?

By restoring the funds' ability to tap into the liquidity buffers they have in place today without the potential of exacerbating the situation through fear of the regulatory repercussions, combined with a potentially higher liquidity target, funds should be well positioned to absorb the outflows in a similar time of liquidity strain and market stress. Again, much of the strain and forced selling of these funds revolved around not a fear of inadequate liquidity in the portfolio but inadequate liquidity to meet regulatory requirements, for which the repercussions were the potential for a forced loss of liquidity through the imposition of liquidity fees or redemption gates.