BETTER MARKETS

May 7, 2020

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
Suite 3E-218
400 7th Street, SW
Washington, DC 20219

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Robert E. Feldman
Executive Secretary
Attention: Comments/RIN 3064-AF41
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Regulatory Capital Rule: Money Market Mutual Fund Liquidity Facility – OCC Docket No. OCC-2020-0011; Board Docket No. R-1705 and RIN 7100-AF79; FDIC RIN 3064-AF41

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the "interim final rule with request for comment" ("Rule"),[2] issued by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Board"), and the Federal Deposit Insurance Corporation ("FDIC") (the OCC, the Board, and the FDIC collectively, the "Agencies"),

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

2 85 Fed. Reg. 16,232 (March 23, 2020).

regarding regulatory relief for banks participating in the recently established "Money Market Mutual Fund Liquidity Facility" ("MMLF").

We believe that the Rule is a reasonable measure that is likely to encourage bank participation in an emergency lending facility that has recently become necessary to alleviate the extraordinary pressures facing money market mutual funds ("MMFs") as a result of the Covid-19 pandemic. A foreseeable, predictable, and indeed predicted run has materialized in MMF markets, causing liquidity pressures, fire sales, downward price spirals, and other contagions. We are submitting this comment letter not to critique the Rule but to highlight once again the continuing vulnerability of MMFs to financial crises and the indefensible failure of the appropriate regulators—in this case, the Securities and Exchange Commission ("SEC") and the Financial Stability Oversight Counsel ("FSOC")—to fully address that vulnerability with a sufficiently robust and effective set of regulatory requirements.

That persistent regulatory failure has made it abundantly clear that we will not see the necessary MMF reforms unless, at a minimum, advocates draw attention whenever possible to what should be obvious: With $4.7 trillion in assets, MMFs remain a huge, highly interconnected, hair-trigger vulnerability of the financial system, and unless properly regulated, they will always be a source of dangerous financial market instability requiring repeated taxpayer-funded bailouts and backstops. In fact, MMFs are a classic example of a financial market where profits are privatized while losses are socialized, as repeatedly demonstrated by the 2008 and now 2020 bailouts. The industry effectively has a "put" on the Federal government to protect against runs in times of stress.

The recurrence of severe instability in MMFs today, the resulting knock-on effects for the broader financial system, and the Agencies' response in the form of the MMLF and the Rule, are appropriate occasions for a review of the need for comprehensive MMF reform. In addition, the Agencies represent an especially appropriate audience because their Chairpersons each serve as members of the FSOC.

OVERVIEW OF THE RULE

The Release explains that because the Covid-2019 pandemic has slowed economic activity so dramatically in the United States and globally, MMFs are facing a substantial increase in redemption requests "from clients with immediate cash needs."[3] This pattern may require MMFs to sell a "significant number of assets" to meet those demands, which could in turn increase "market pressures."[4] To prevent this disruption in the money markets "from destabilizing the

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3 Release at 16,234.
4 Id.

financial system," the Board authorized the Federal Reserve Bank of Boston to establish and operate the MMLF, pursuant to Section 13(3) of the Federal Reserve Act. Under that facility, the Boston Fed will extend non-recourse loans to eligible financial institutions to purchase assets from MMFs.[5]

To facilitate bank participation in this lending program for the benefit of MMFs, the Rule would allow banking organizations to "neutralize the effects of purchasing assets through the program on risk-based and leverage capital ratios."[6] In other words, the Rule would permit participating banking organizations to exclude non-recourse exposures acquired through the MMLF from the banks' capital ratios, both risk-weighted and leverage-based. The Release emphasizes that this approach is appropriate because of the non-recourse nature of the credit extended to the banks via the MMLF.[7] Due to the non-recourse nature of the loans, banks are not exposed to either credit or market risk from the assets purchased, and omitting those assets when calculating the banks' capital requirements is therefore appropriate.[8] The Release notes that this regulatory capital treatment was also extended to banks during the 2008 financial crisis for assets purchased through the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, a similar emergency facility established to stabilize MMFs and the commercial paper market.[9]

COMMENTS

While the Rule may be a necessary and appropriate step to help stabilize the financial markets in this time of extraordinary economic turmoil and uncertainty, regulators must ultimately impose stronger, long-term regulatory measures to ensure that MMFs become more resilient and less prone to market-threatening instability during periods of financial market stress. The nature of MMFs; the lessons from the 2008 financial crisis; today's current market turmoil; and the incremental and incomplete reforms to date all support this fundamental point. We review those core issues briefly below.[10]

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5 Id.
6 Id.
7 Id.
8 Id.
9 Id. at n. 3.
10 Better Markets has addressed all of these issues at greater length in a series of comment letters and other materials issued since at least 2013. See Better Markets Comment Letter to FSOC on Proposed Recommendations Regarding Money Market Fund Reform (February 15, 2013), available at https://bettermarkets.com/sites/default/files/FSOC-%20CL-%20MMF%20Recommendations-%202-15-13.pdf.; Better Markets Comment Letter to SEC on Money Market Reform; Amendments to Form PF (September 17, 2013), available at https://bettermarkets.com/sites/default/files/SEC-%20MMF%20Reform-%209-17-13.pdf; Better Markets Fact Sheet: Money Market Funds Are Failing and Being Bailed Out Again, As They Were During the 2008 Financial Crisis Just Twelve Years Ago (Mar. 26, 2020), available at

- **<u>MMFs are a vast and important segment of the financial system, which can incubate and propagate financial instability.</u>** The widespread impact of MMFs on the financial system is a function of the sheer size of the MMF market, the concentration in the MMF industry, and its interconnectedness with the credit markets. MMFs have grown enormously since their inception, amassing over $4.7 trillion in assets. MMFs are connected to the financial markets in many ways. They provide substantial short-term funding to a wide array of companies, financial firms, and governmental entities. They are also heavily involved in the tri-party repo market. They are enmeshed in the banking system, as MMFs are extensively sponsored by subsidiaries of banks and savings and loan holding companies. MMFs are widely used as cash management vehicles by individuals, businesses, institutional investors, and governments, which depend on immediate and unfettered access to their money. Finally, MMFs are internationally connected as well, as many foreign firms depend on financing via MMFs, thus making domestic MMFs sensitive to stress in global markets. Thus, based on size, function, and interconnectedness, MMFs present an ongoing risk of runs that are capable of spreading widely and rapidly throughout the financial system.

- **<u>Past experience vividly demonstrated the need for stronger MMF regulation.</u>** In the early days of the 2008 crisis, a prominent MMF experienced a wave of redemptions, famously broke the buck, sparked a panic, triggered a run on prime MMFs, and precipitated a liquidity crisis in short-term wholesale funding markets. In response, and for the first time in history, on September 19, 2008, the Treasury Department and the Federal Reserve were forced to implement a series of emergency measures effectively guaranteeing the entire $3.4 trillion MMF industry. Effectively, every U.S. taxpayer was put on the hook. These actions from the first days of the 2008 financial crisis vividly demonstrated that MMFs are systemically significant and can spread destabilizing risk rapidly throughout our financial system. And the near meltdown in 2008 was not the first time—or the last—that MMFs faced significant stresses and potential collapse. Over the years, many MMFs would have broken the buck had it not been for sponsor support.

- **<u>Current stresses on MMFs are once again severe.</u>** While the Release simply states that the recent disruptions in the financial markets have put "increasing liquidity pressure" on MMFs,[11] the pressure has been intense, prompting the Fed to establish the MMLF and leading the Agencies to issue the Rule. The rulemaking was conducted on an emergency basis and in reliance on multiple exceptions to the requirements normally governing comment periods and effective dates. Numerous recent reports indicate that the assets of prime MMFs have been dropping dramatically. For example, ICI data shows that prime MMF assets dropped by $85.38 billion, or over 10%, between March 4 and March 18,

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https://bettermarkets.com/resources/fact-sheet-money-market-funds-are-failing-and-being-bailed-out-again-they-were-during-2008.

11 Release at 16, 234.

2020. Some funds have been faring much worse, with their assets falling by as much as 50% as investors withdraw. And many MMF sponsors have been forced to backstop their MMFs with cash infusions to prevent them from "breaking the buck" as they sell assets to meet redemptions as asset classes are falling in value. Among the most prominent sponsors forced to provide this support are Goldman Sachs and BNY Mellon. As a result, the $2 trillion fiscal rescue legislation recently passed in March renewed the Treasury Department's authority to guarantee the MMF industry again.[12] This puts the full faith and credit of the United States behind a single financial product, just as the government and the taxpayers did in 2008. That should never be tolerated in a free market economy and it only occurs here because MMFs have been allowed to externalize their run-risk and contagion costs to the government and taxpayers, rather than being properly regulated.

- **The SEC's initial regulatory responses were knowingly incomplete and deficient, prompting even the FSOC to recommend stronger action.** The SEC's initial response to the 2008 MMF crisis was incremental, incomplete, and ineffective. As a first step, in 2010, the SEC strengthened the liquidity, credit quality, and maturity standards governing MMF portfolio investments. While these were important measures, they fell far short of the response that was necessary to prevent a repeat of the 2008 bailout and protect taxpayers. The need for much stronger action against MMF instability was so clear and convincing, indeed overwhelming, that in November 2012, the FSOC, by unanimous vote, took the extraordinary and unprecedented step of issuing "Proposed Recommendations" directed to the SEC, setting forth necessary structural MMF reforms that would reduce the risk of destabilizing runs. Those proposals included floating the net asset value or "NAV" and, significantly, a capital buffer. Better Markets strongly supported those proposals.

  The FSOC's 2012 recommendations prompted the SEC to act, but the result was a handful of piecemeal and insufficient reforms in July of 2014. The SEC essentially (1) required institutional MMFs to float their NAVs (while excluding two-thirds of all MMFs from this requirement), and (2) gave MMFs discretion to impose liquidity fees and redemption gates whenever weekly liquid assets dropped below certain levels. Better Markets strongly supported these measures as well, but strenuously urged the SEC to go much further, arguing that the SEC should float the NAV for all funds to mitigate run risk, promote transparency, and treat all investors more fairly. We also urged the SEC to require MMFs to maintain capital buffers that could absorb significant losses, thus promoting stability, instilling investor confidence, and reducing the likelihood of damaging runs. Without such actions, future MMF failures, systemic instabilities, and bailouts were inevitable. However, the SEC failed to implement those reforms, and the FSOC did not press the SEC to take further action.

12 Section 4015 of the CARES Act, Public Law No. 116-136 (Mar. 27, 2020).

- **As a result of the SEC's steadfast refusal to take the appropriate and plainly necessary actions to end MMFs instability, taxpayers are on the hook again and the lesson is clear: Fix the problem once and for all.** Once again, American taxpayers, via the Federal Reserve and the Treasury Department, are being forced to bail out or backstop the MMF industry, because policymakers and regulators failed to do their jobs, failed to learn obvious lessons from just 12 years ago, and failed to shore up a weak regulatory framework that has once more—predictably—put the financial system at risk. After the current crisis subsides, those policymakers and regulators must close the regulatory gaps in the MMF markets once and for all through an array of measures, from the floating NAV for all MMFs to meaningful capital buffers, as we have previously detailed.[13]

CONCLUSION

We hope you find these comments helpful and we hope regulators will quickly take all necessary and appropriate action to ensure that this is the last time MMFs must be bailed out.

Sincerely,

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13 *See* materials cited at note 10 *supra.*