STATE STREET GLOBAL ADVISORS

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State Street Global Advisors
1 Iron Street
Boston
MA 02210
United States

ssga.com

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Submitted via email to: rule-comments@sec.gov

Re: Request for Comment on Potential Money Market Fund Reform Measures in President's Working Group Report (File No. S7-01-21)

Dear Ms. Countryman:

State Street Global Advisors (SSGA) welcomes the opportunity to provide input on the U.S. Securities and Exchange Commission's (SEC) Request for Comment[1] on the potential reform options for money market funds (MMFs), as set out in the President's Working Group (PWG) December 2020 Report[2]. SSGA is the investment arm of State Street Corporation[3] and, with $3.47 trillion in assets under management[4] , as of December 31, 2020, is one of the largest asset managers in the world. For more information, please visit SSGA's website at www.ssga.com.

The market volatility observed in March and April of 2020 was a real-life stress test for global financial markets and the post-2008 regulatory frameworks under which they operate. As the effects of the COVID-19 pandemic rippled through the global economy, the exceptional and unprecedented demand for liquidity resulted in particularly acute pressure being felt in short-term funding markets. The MMF sector, as a highly-visible and transparent constituent of short-term funding markets, also faced liquidity challenges, although this experience was not homogenous across the various types of MMFs. While

[1] Document Citation: 86 FR 8938 – available at https://www.federalregister.gov/documents/2021/02/10/2021-02704/request-for-comment-on-potential-money-market-fund-reform-measures-in-presidents-working-group

[2] Available at https://home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf

[3] Headquartered in Boston, Massachusetts, State Street Corporation is a global custodian bank which specializes in the provision of financial services to institutional investor clients. This includes the provision of investment servicing, investment management, data and analytics, and investment research and trading. With $38.791 trillion in assets under custody and administration, and approximately $3.47 trillion of assets under management, State Street operates in more than 100 geographic markets globally as of December 31, 2020. State Street is organized as a United States bank holding company, with operations conducted through several entities, primarily its wholly-owned state-chartered insured depository institution, State Street Bank and Trust Company.

[4] Assets under management as of December 31, 2020 includes approximately $75 billion of assets with respect to SPDR® products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

government MMFs received exceptional inflows, suggesting they were the vehicle of choice for investors in their search for a safe haven, institutional prime MMFs faced substantive outflows. The market volatility seemingly only abated following the actions taken by the U.S. Federal Reserve to stabilize markets, including the introduction of the Federal Reserve's Money Market Mutual Fund Liquidity Facility (MMLF). This experience has once again brought policymaker scrutiny onto prime MMFs.

State Street Global Advisors is supportive of efforts being undertaken by policymakers to improve the resilience of short-term funding markets, including money market funds. However, it is important to recognize that the challenges faced by market participants were not limited to MMFs and, as such, an effective solution will not be found through further reforms to Rule 2a-7 alone. In our view, the outcome of the review process and any subsequent reforms should also be targeted at addressing the underlying issues observed during the pandemic-related market stress, which was inherently a liquidity-driven episode caused by extreme uncertainty and market volatility spikes that led to dislocations, temporary shortages of liquidity and valuation issues in parts of the market. In addition, future reforms to money market funds should not undermine the ongoing viability of prime MMFs.

As described in more detail in our response, we believe prime MMFs continue to play a valuable and crucial role, whether as an investment vehicle for investors, as a source of funding for issuers and the real economy, and as facilitators of liquidity for financial markets more broadly. Nevertheless, we acknowledge the challenges faced by short-term funding markets during March and April 2020 and provide some key observations in this regard. Finally, as part of our response, we propose a number of key principles that we believe should underpin future reforms, paying due regard to the options outlined in the PWG Report.

The Role of Prime Money Market Funds

Prime MMFs play a crucial role in short-term funding markets. For investors, such as corporate treasurers, state/municipal authorities and pension funds, prime MMFs provide an operationally simple, cost-effective investment vehicle that is principally used for cash and liquidity management purposes. This reflects the nature of such investments, which typically represent cash for short-term financing requirements, including payroll and day-to-day expenses. While prime money market funds do endeavor to provide investors with a relatively advantageous yield position, in a normalized interest rate environment, this is only a secondary consideration. From an operational perspective, investors value same-day settlement and the treatment of investments into prime MMFs as cash-and-cash-equivalent for accounting purposes, which is often a requirement of their internal investment policies.

Similarly, on the assets side and for issuers, MMFs are an important source of funding for a range of market participants, including governments, corporates and financial institutions, ultimately supporting the activities of the real economy. While the assets held in prime MMFs, as a proportion of total MMF assets, has decreased in recent years, most notably following the implementation of the SEC's 2014 reforms to Rule 2a-7, it remains sizable; the Investment Company Institute (ICI) estimates that assets held by prime MMFs stood at $526bn as of March 3, 2021. This constitutes a substantial amount of important funding for a variety of market participants which could not be easily replicated. Collectively, prime MMFs remain significant holders of commercial paper (CP). While this is markedly lower than pre-2008, where MMFs were estimated to hold more than a third of outstanding CP, as of June 2020, they remain the second largest holders, representing 21% of the total amount of CP issuance outstanding[5].

In this context, we believe that eliminating prime MMFs, either directly or indirectly through new regulatory requirements that are not commercially feasible, would have a material detrimental impact on investors and the real economy. We are concerned that some policymakers may be making the assumption that cash typically invested in prime money market funds could simply move to other investment vehicles, such as government MMFs or bank deposits, with no harm or distress to the system. However, post-global financial crisis (GFC) reforms to prudential requirements for banks has resulted in their becoming less willing to accept short-term operational cash, given this is relatively more capital intensive to accommodate. Similarly, the comparatively low yield offered by these products may result in some investors seeking opportunities in less transparent and more thinly regulated investment vehicles. Given the highly-regulated and highly-transparent regulatory framework for MMFs, we believe this would be a sub-optimal outcome from a public policy perspective.

Key Observations from the Market Stress in March 2020

It is imperative that policymakers recognize the differences between the market stress in March 2020 and the global financial crisis in 2008. The latter was an endogenous event, primarily driven by solvency concerns of certain large financial institutions that subsequently permeated all aspects of the economy. In March, it was an exogenous shock that initiated outside of financial markets, namely a global public health crisis, that precipitated a sudden and unprecedented increase in the demand for liquidity, impacting even traditionally the safest financial instruments (e.g. US Treasuries). It is a similar case when considering MMFs more specifically. In 2008, outflows were driven by concerns over constant Net Asset Value (NAV) funds potentially 'breaking the buck', whereas in March 2020, outflows largely represented market participants seeking to build up their

[5] ICI Report of the COVID-19 Market Impact Working Group, "Experience of US Money Market Funds During the COVID-19 Crisis", November 2020

liquidity positions, in light of the extreme economic uncertainty brought about by the near-total shutdown of the global economy.

In this regard, MMF flows were indicative of a 'flight to safety' rather than a 'flight to quality' i.e. investor flows were driven by their prioritization of access to liquidity rather than as a result of concerns regarding the underlying credit quality of investments in MMFs. It is worth noting that during March, the inflows into government MMFs ($862 billion) significantly outweighed the outflows from institutional prime MMFs, which totaled $96 billion, and indeed continued well after prime MMFs themselves started to observe net inflows. In contrast, in 2008, outflows from prime MMFs were matched almost one-for-one by inflows into government MMFs. This reflects government MMFs becoming a vehicle of choice among a broad range of investors, further emphasizing the flight to safety and the prioritization of access to liquidity over yield, given the continued economic uncertainty.

It is important to emphasize that MMFs were not the cause of the pandemic-related market volatility. While we are not seeking to downplay the severity of the issues faced by MMFs, the significant outflows observed did not instigate but rather followed the initial dislocation experienced by broader short-term markets, amid an ever-increasing demand for liquidity by investors. Moreover, since the publication of the PWG Report, others have posited the idea that MMFs may have exacerbated market conditions by disposing of their less liquid assets to meet redemptions and sought to build up their holdings of weekly liquid assets (WLA), primarily through U.S. Treasuries and other government obligations. However, for fund types for which the primary purpose is the provision of liquidity and the preservation of principal, such as MMFs, this seems entirely logical in light of market events and we believe was reflective of prudent risk management.

It is clear to us that previous Rule 2a-7 reforms may have contributed to the challenges in 2020. In particular, the introduction of fees and gates and its explicit link to MMFs' minimum 30% weekly liquid assets threshold may have encouraged procyclical behavior by investors. There is evidence to suggest that during the peak of the market turmoil, the 30% WLA became a very salient figure from the perspective of investors, with funds that approached the threshold facing increased redemption pressure, due to investor concerns over temporary loss of access to their cash. We believe this is contrary to the SEC's intention when fees and gates were introduced, as part of the 2014 reforms. Specifically, the SEC states in its Final Rule[6]:

"Nonetheless, for the reasons discussed in this Release, fees and gates provide funds and their boards with additional tools to stem heavy redemptions and avoid the type of

[6] SEC Final Rule, Money Market Fund Reform, Amendments to Form PF; Release No. 33-9616, IA-3879; IC-31166; FR-84; File No. S7-03-13 – available at https://www.sec.gov/rules/final/2014/33-9616.pdf

contagion that occurred during the financial crisis by allocating liquidity costs to those shareholders who impose such costs on funds and by stopping runs."[7]

The practical effect of this was that a large portion of a MMF's inherent liquidity was rendered unusable and many became forced sellers in order to maintain additional buffers over and above minimum regulatory requirements, to ease investor concerns, at a time when market liquidity was already scarce. During March 2020, we observed that institutional prime MMFs were holding, on average, WLA of approximately 45%.

Furthermore, while we recognize the scope of the PWG Report is limited to considering MMFs specifically, for reforms to be meaningful and effective, it is clear that policymakers will also need to consider addressing underlying structural issues in short-term funding markets. Despite significant market developments, short-term funding markets remain highly intermediated and dependent on banks for the provision of secondary market liquidity. However, as seen in March 2020, MMF managers were unable to utilize secondary market liquidity at a time when it was most needed, as broker-dealers were either unable or unwilling to engage in discretionary market-making, but rather sought to preserve their own balance sheet capacity. This may have been an unintended consequence of post-GFC prudential reforms which, while undoubtedly have improved the resilience of the banking sector, may have altered incentives regarding their market-making activities.

We note that a number of these elements were directly referenced by Liberty Street Economics, which is affiliated with the Federal Reserve Bank of New York, in their recent publication titled "Did Dealers Fail to Make Markets during the Pandemic?"[8]. The authors highlight that the combination of dealer risk management and regulation, and the subsequent impact on balance sheet capacity, may have limited broker-dealers' ability to make markets. When considering how such capacity could be improved, the authors conclude:

"[...] Whatever the approach, the sharp decline in market liquidity during the pandemic lends urgency to initiatives that might enhance intermediation capacities of the dealer community."[9]

Key Principles for Reform

In line with our observations from March 2020, we have identified a number of high-level principles that we strongly believe should underpin future reforms.

[7] P.44, Ibid

[8] Jiakai Chen, Haoyang Liu, David Rubio, Asani Sarkar and Zhaogang Song, "Did Dealers Fail to Make Markets during the Pandemic?", *Liberty Street Economics* (March 24, 2021) – available at https://libertystreeteconomics.newyorkfed.org/2021/03/did-dealers-fail-to-make-markets-during-the-pandemic.html

[9] Ibid.

1. **Focus on the challenges revealed during the market stress**

First and foremost, reforms must seek to address the challenges observed during the market volatility, notably in that it was a market-wide liquidity event. In this regard, we see little merit in considering previously-proposed reform options that may have been more targeted at addressing credit-risk. Similarly, reforms should aim to reduce or eliminate run-like behavior among investors.

As such, we support the proposals in the PWG Report that seek to improve the usability of a fund's liquidity. In particular, we strongly support the proposal to remove the link between MMF minimum liquidity requirements, namely the 30% WLA threshold, and the potential imposition of liquidity fees and redemption gates (Option A). As noted, this may have encouraged investor redemptions, resulting in the counterintuitive scenario whereby funds had high levels of liquidity that was effectively unusable at a time when it was most needed. Similarly, many MMFs became forced sellers into stressed market conditions to maintain an additional buffer; while these actions may have assuaged investor concerns, it was not necessarily in their best interests.

Given the intense scrutiny on the 30% WLA, as part of the 'de-linking', there will likely need to be significant investor education and efforts to increase awareness. Regulators may also wish to consider issuing guidance on when fees and gates should be considered, as well as what happens in the event that a fund's WLA dips below 30%. Regarding the latter, one option would be to build on current market practice whereby the MMF is limited to actions that restore its WLA above the minimum threshold. This may help to reduce the "bright line effect" while permitting funds to utilize fees and gates where necessary and in the interests of the fund and its investors. We believe a combination of Option A, alongside reforms to conditions for the imposition of redemption gates (Option B) and countercyclical weekly liquid asset requirements (Option E), would most directly address the challenges faced by MMFs during the period of market volatility.

2. **Ensure ongoing viability of Prime MMFs**

Reforms should also ensure the ongoing viability of prime MMFs. As previously highlighted, we continue to believe that prime MMFs play a critical and valuable role in financial markets, and that the outcome of the reform process should not materially diminish their capacity to do so going forward. In addition to the benefits provided to investors and issuers, as set out earlier, prime MMFs facilitate broader market liquidity. As such, we do not see the merit in proposals that could further reduce market liquidity, particularly in the context of a response to a market-wide liquidity crisis.

In line with this view, we do not support the requirement for MMFs to hold minimum capital buffers (Option H), which are generally not common features for investment funds. Operationally, it will be difficult to calculate what is deemed to be a sufficient buffer. Similarly, as noted in the PWG Report as well as in supporting academic literature, capital

buffers are intended to protect investors against credit-related losses. As such, the suitability and appropriateness of capital buffers in addressing market-wide liquidity events, particularly of the magnitude of March 2020, is not immediately clear. Separately, we do not agree with the suggestion that capital buffers may help curb risk-taking by the fund. In the context of fund holdings, the stringent regulatory framework applicable to MMFs, particularly in relation to minimum liquidity and portfolio composition, will ensure that MMFs already invest in high-quality, highly-liquid assets. On the contrary, in order for the maintenance of a capital buffer to be economically viable, a manager may be incentivized to take on more risk. Furthermore, if there are penalties or costs associated with accessing or using these buffers, it may further entrench the 'bright line' effect.

We believe there are similar considerations for the proposals on minimum balance at risk (MBR – Option C) and the requirement for liquidity exchange bank (LEB) membership (Option I). Regarding the MBR, this proposal ignores the type of investors in, and the value proposition presented by, MMFs. Rather than discourage investors from redeeming, limiting investors' access to their cash or expressly introducing a mandatory first-loss-absorbing element into their investment is likely to push them out of prime MMFs altogether. Regarding the LEB, we understand this proposal was considered during previous rounds of reform, but it was the SEC itself that questioned whether this would be a meaningful or effective solution.

3. **Address underlying market structural issues**

An additional principle is that reforms should not be targeted at MMFs alone but also consider underlying structural issues, in both the short-term funding market and fixed income markets more broadly, in order for reforms to be truly effective. As noted, one aspect of this is the effect of post-2008 prudential reforms for banks and the impact this may have had on their capacity to undertake discretionary market-making activities. While we are not advocating for a significant overhaul of prudential rules, it was abundantly clear that balance sheet constraints faced by banks severely impaired their willingness and/or ability to play their traditional intermediary role and provide secondary market liquidity, in some cases in relation for paper issued in their own name or asset-backed commercial paper (ABCP) programs where they are a named sponsor. This may have further exacerbated the market stress.

4. **Avoid the need for external support**

The final principle is that reforms should avoid the need for external support, whether that be from the public sector or indeed the fund sponsor and/or its affiliates. With regards to the former, while we do not have specific solutions at this stage, we are confident and willing to work with policymakers to develop a robust framework that ensures the viability of prime MMFs while reducing the potential need for future support from public authorities. Notwithstanding this, we believe there should be recognition that during periods of extreme market stress, or 'black swan' events, normal functioning may only be

restored through policymaker intervention. We note that this was reflected in comments made by Mark Carney, former Governor of the Bank of England and Chair of the Financial Stability Board, and Gary Cohn, former Director of the U.S. National Economic Council during the SEC's Roundtable on Interconnectedness and Risk in U.S. Credit Markets in October 2020.

Regarding sponsor support (Option J), we are not in favor of proposals to facilitate this further, which we note is inconsistent with the broader international financial stability debate and, in particular, reducing the interconnectedness between the bank and non-bank sectors. Additionally, given many providers of MMFs are standalone investment management firms, this may favor the largest providers and those that are part of a banking group.

Additional Considerations

The reform option that has perhaps garnered the most attention is the use of swing pricing (Option G). Similar to our views on liquidity fees and redemption gates, we are not opposed to swing pricing; on the contrary, we believe it can be a valuable liquidity management tool. Swing pricing typically works by applying a percentage (referred to as the swing factor) to the NAV per share, thereby adjusting the prevailing price for the relevant transaction (either an increase for a subscription or a decrease for a redemption). This ensures that the costs associated with the relevant activity are borne by the redeeming/subscribing investor and not the fund's long-term investors. However, the operational aspects mean that it is not easily applicable to MMFs.

In particular, almost all MMFs operate on a T+0 settlement cycle and many will strike the NAV multiple times a day (i.e. provide intra-day redemptions). Given swing pricing is based on net flows, which are not known until the end of the day, it could result in the scenario where investors are treated differently; an investor redeeming at an earlier price point may not necessarily incur the market effect, whereas investors redeeming at the last price point in the day (and will receive their cash the next day) may have to incur the market effect of both their redemption and that of investors redeeming earlier in the day. This would likely be exacerbated during periods of market stress and particularly 'black swan' events like March 2020, where anticipating investor flows is made significantly more challenging. Furthermore, as recognized in the PWG Report, swing pricing is not a common feature among mutual funds in the United States.

Concluding Remarks

State Street Global Advisors is grateful for the opportunity to provide input to the SEC on potential reform options for MMFs. As elaborated in our response, in our view, reform options should be underpinned by several key principles. In line with this approach, we are supportive of proposals that ensure managers are able to fully utilize a MMF's inherent

liquidity. Regarding the other proposals set out in the PWG Report, we believe they would either not address the relevant issues or would materially undermine the viability of prime MMFs.

Notwithstanding the above, it is our intention to be an active and constructive participant in this debate, and we remain supportive of efforts to improve the resilience of MMFs, as well as broader short-term funding markets. We look forward to contributing to these discussions with both US and international policymakers. Should you wish to discuss any aspect of our response, please do not hesitate to contact me or a member of my team.

Your sincerely,

Matthew J Steinaway, CFA

Chief Investment Officer – Global Fixed Income, Currency and Cash

State Street Global Advisors