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FSB final report on money market fund reform

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The Financial Stability Board (FSB) this week published a final report recommending policy reforms to enhance the resilience of money market funds (MMFs). The policy recommendations in the final report are generally identical to the proposals made in the FSB's June 2021 consultation report, as discussed in detail in our earlier client update.

The FSB Report recommends that regulators consider seven policy options to address MMF vulnerabilities: 1) swing pricing, 2) minimum balance at risk rules, 3) capital buffers, 4) removing ties between regulatory thresholds and imposition of fees and gates, 5) requiring all MMFs to have a variable net asset value, 6) limits on eligible assets, and 7) additional liquidity requirements and escalation procedures that require certain steps to be taken before gates are imposed. As in the consultation report, "extensions and variants" of these seven options are also contemplated.

In the report, the FSB emphasized that the market turmoil in both 2008 and March 2020 exposed vulnerabilities in MMFs that must be addressed. The FSB's recommendations focus on two broad types of vulnerabilities: (1) that MMFs are susceptible to sudden and disruptive redemptions, and (2) they may face challenges in selling assets, particularly under stressed conditions.

In its summary of comments received on the consultation report, the FSB explained that, in its view, the comments it received from stakeholders "did not introduce major new elements to the analysis," and therefore the final report is substantially similar to the June 2021 consultation. One modest change the FSB did make to the final report, however, was to clarify that its swing pricing policy option would also include "economically equivalent" measures. The FSB explained that if swing pricing is difficult to implement in a given country, regulators in that country may instead adopt economically equivalent policies—such as imposing a cost on redeeming investors in the form of liquidity fees or anti-dilution levies—so long as they are "implemented in a manner that is likely to pass on to redeeming investors the costs they impose on the fund without creating incentives for pre-emptive runs."

The FSB is not advocating any specific option from the menu of approaches set out above, and has stated that, depending on the country, there may be several options that would achieve desired outcomes.

Next steps in the MMF reform process

The FSB Report does not impose any new regulatory requirements on MMFs. Instead, regulators in each country must decide which, if any, policy approach they will implement.

In the United States, as discussed in a previous Davis Polk client update, the SEC requested comment earlier this year on potential MMF reforms, many of which are consistent with those included in the FSB report. As of this spring, the SEC had indicated in its semi-annual regulatory agenda that a notice of proposed rulemaking could be issued by April 2022, but more clarity on the SEC's timing may be provided in the coming months.[1]

For its part, the Financial Stability Oversight Council has stated that it intends to “continue to monitor [the SEC’s MMF reform] initiative in the broader context of efforts by financial regulators to strengthen short-term funding markets and support orderly market functioning, including during periods of heightened market stress.”

By the end of 2023, the FSB will review the progress made by its member countries as they adopt reforms to enhance MMF resilience. It will then assess the effectiveness of these measures in addressing risks to financial stability by 2026.

Law clerk Lucas Siegmund contributed to this update.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Luigi L. De Ghenghi
+1 212 450 4296
luigi.deghenghi@davispolk.com

Gabriel D. Rosenberg
+1 212 450 4537
gabriel.rosenberg@davispolk.com

Gregory S. Rowland
+1 212 450 4930
gregory.rowland@davispolk.com

Margaret E. Tahyar
+1 212 450 4379
margaret.tahyar@davispolk.com

[1] In a September 2021 hearing before the Senate Banking Committee, SEC Chair Gary Gensler indicated that a proposed rule could be released by as early as Q1 of next year. See SEC Chair Gary Gensler, Senate Banking Committee Hearing on Oversight of the U.S. Securities and Exchange Commission, Sep. 14, 2021, https://www.banking.senate.gov/hearings/09/10/2021/oversight-of-the-us-securities-and-exchange-commission.