Money Market Funds Weather Liquidity Crunch

Post-GFC regulations and Fed programs support money funds.

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KEY INSIGHTS

- We believe the ability of the money markets to function relatively well in environments challenged by both credit problems and illiquidity sends a positive signal.
- The Fed took a money market backstop from the GFC "off the shelf" and quickly re-implemented it, showing how lessons learned then can be applied now.
- We believe the money fund industry has emerged from the current crisis positioned for stability as a result of post-GFC regulations and aggressive central bank support.

Recently implemented Federal Reserve measures, combined with money market fund regulations established after the global financial crisis (GFC), supported money funds through the March liquidity crisis. The coronavirus pandemic triggered selling pressure and reduced liquidity in almost all financial markets as investors rushed into cash. This contrasts with the GFC, when credit problems caused a loss of confidence in money market funds. We believe the ability of the money markets to function relatively well—albeit with support from the Fed—in environments challenged by both credit problems and illiquidity sends a positive signal about the stability of money market funds industrywide.

Fed Helped Stabilize Money Markets in 2008

In 2008, a large, non-T. Rowe Price money market fund "broke the buck" when its net asset value fell below USD 1.00 per share as a result of its exposure to debt issued by Lehman Brothers. This caused a run on (or massive redemptions of) other money market funds, driven primarily by institutional holders. The Fed offered emergency loans to money funds, and the Treasury Department implemented an insurance program that essentially all money market funds participated in. These actions stabilized the market and restored confidence in money funds.

Separating Institutional Prime Funds

After the GFC, regulators required fund sponsors to separate institutional prime[1] and municipal money market portfolios from funds for individual investors.

[1] Prime money market funds can hold instruments with credit risk.

> The money market fund regulations implemented after the GFC performed well in the March sell-off...

The goal was to insulate individual investors in mutual funds from major selling by institutional investors.

In an additional post-GFC measure to avoid runs on money market portfolios, funds that invest in nongovernment securities must now maintain at least 10% of their assets in instruments that can be liquidated in one day and an additional 20% in securities that can be liquidated in seven days. If a fund breaches these minimum liquidity levels, it can implement fees on redemptions or "gates" to temporarily stop them. Gates work something like stock market circuit breakers in that they are designed to slow redemption momentum. T. Rowe Price money market funds have maintained exposure to liquid assets, as defined above, well above the regulatory minimums noted and have never enacted redemption fees or gates.

Fed Steps in Again in 2020

Amid the liquidity crunch across financial markets in March 2020, the commercial paper[2] market essentially froze. This triggered fears that many prime money market funds would breach their minimum levels of liquid assets and impose redemption fees or gates. On March 17, the Fed announced that it would buy highly rated commercial paper, which helped free up liquidity in that market.

Days later, the Fed launched the Money Market Mutual Fund Liquidity Facility (MMLF) by adapting a program from 2008 to lend money to securities dealers to purchase money market instruments. The MMLF succeeded in bolstering confidence in money market liquidity. The Fed's ability to take a money market backstop (or support) from the GFC essentially "off the shelf" and quickly re-implement it illustrates how lessons learned then can be applied to the current crisis. Along similar lines, we believe the Treasury Department could also opt to restart a money market fund insurance program if needed.

Money Funds Positioned for Ongoing Stability

The money market fund regulations implemented after the GFC performed well in the March sell-off, although the recent financial stress stemmed from a lack of liquidity, not from credit problems as in 2008. In theory, the minimum liquidity levels now required of money market funds could have resulted in some institutional funds instituting fees or gates on redemptions as the market froze, but the Fed's quick action helped support the market. We believe that the money fund industry has emerged from the worst of the current crisis in good position for ongoing stability as a result of post-2009 regulations and aggressive central bank support.

WHAT WE'RE WATCHING NEXT

The Treasury Department will need to increase its issuance of debt across all maturities to fund the government's massive fiscal stimulus programs designed to help cushion the impact of the coronavirus pandemic on the U.S. economy. While the Treasury Department may prefer to lock in low interest rates by issuing longer-term bonds, we expect a significant boost in the supply of Treasury bills, which have maturities of 12 months or less.

[2] Unsecured debt issued by companies to fund short-term obligations.

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