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Asset Management ADVocate

Information on the Prime and Tax Exempt Money Market Fund Liquidity Facility (Updated 3/23)

The Federal Reserve Bank of Boston ("FRBB") has established a new Money Market Mutual Fund Liquidity Facility. (I'm not sure what acronym to use here; "mmm … Fund Liquidity" would work. Let's just call it the "Facility.") The Facility opened on March 23, 2020. This post summarizes the significant terms of the Facility and suggests an idea for fund boards to consider.

Indirect Liquidity for Prime and Tax Exempt Money Market Funds

The FRBB deals with banking institutions, not mutual funds. Thus, only U.S. bank holding companies (and their SEC registered broker-dealer subsidiaries), U.S. depository institutions and U.S. branches of foreign banks ("Eligible Borrowers") may borrow from the Facility. The Facility supports prime and tax exempt money market funds (money market funds that do not invest almost exclusively in U.S. government securities, "Funds") because loans from the Facility must be secured with collateral purchased from Funds. Basically, an Eligible Borrower will purchase collateral from a Fund, thus providing the Fund with liquidity to pay redemptions. The Eligible Borrower will immediately borrow the value of the collateral from the Facility using the collateral to secure the loan. The term of the loan (which may not exceed 12 months) will coincide with the maturity of the collateral, so (assuming the discount on the collateral equals or exceeds interest charged on the loan) the loan will be repaid in full when the collateral matures. A fund must have checked the "Prime," "Single State" or "Other Tax Exempt" box in Item A.10 of Form N-MFP to qualify as a Fund. The Facility will terminate on September 30 unless extended by the FRBB.

Eligible Collateral

Eligible collateral includes:

- U.S. Treasuries & fully guaranteed Agencies;
- Securities issued by U.S. Government Sponsored Entities;
- Commercial paper ("CP") (including asset-backed CP) and negotiable certificates of deposit ("CDs") issued by a U.S. issuer; and
- Municipal debt ("Munis") with a maturity not greater than 12 months. Munis include variable rate demand obligations with demand features that may be exercised at intervals of not more than 12 months.

U.S. Issuers include entities organized under U.S. laws and U.S. branches of foreign banks. CP, CDs and Munis must be rated, at the time purchased from the Fund or pledged for a loan, not lower than A1, F1, or P1 (SP1, MIG1 or F1 for Munis) by (a) an NRSRO if it is the only NRSRO rating the CP, CDs or Muni, or (b) two NRSROs if more than one NRSRO rates the CP, CDs or Muni. Munis without short-term ratings (such as BANs) must be rated in one of the top two long-term categories (AA or Aa), without regard to gradations. In addition, the facility may accept receivables from certain repurchase agreements. It will be interesting to see if anyone contrives to transfer this (account, payment intangible?) to an Eligible Borrower. CP, CDs and Munis will be valued at the Fund's amortized cost. Other collateral may be valued at fair value or amortized cost, but there is no indication of when one value would be used instead of the other.

Interest Rate

FRBB will charge interest at its primary credit rate (currently 0.25%) on loans secured by government securities. The rate is one percent higher for loans secured by CP and CDs and 0.25% higher for loans secured by Munis.

Credit Risk

Loans are non-recourse to the Eligible Borrower, so it will not assume any credit risk. The Treasury has undertaken to provide credit protection to the FRBB against defaults on the collateral up to $10 billion.

Impact of the Facility

Fear that, if the weekly liquid assets of a Fund falls below 30% of its assets, its board of directors would suspend or impose a liquidity fee on redemptions has driven some shareholders, particularly institutions, to redeem their shares. Funds can assuage these fears by selling CP, CDs or Munis to Eligible Borrowers to maintain their weekly liquid assets above 30%. Another approach would be for the board of directors of a Fund to meet and announce that, so long as the Facility is available, they would not impose a liquidity fee or gate even if weekly liquid assets fall below 30%. This might help negate the "30% = fees or gates" mentality of some shareholders. It could also help the market understand that fees and gates are not automatic or foreordained whenever weekly liquid assets dip below the threshold.

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