

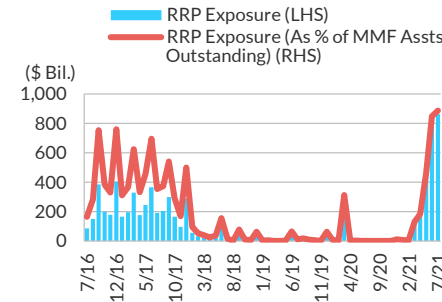
# U.S. Money Market Fund Reform May Impact Fed’s Interest Rate Tools

**MMF Reform Flows Could Reduce Effectiveness of Fed’s Tools:** Proposed U.S. money market fund (MMF) reforms, if enacted, could result in large inflows into government MMFs, and force the Federal Reserve (Fed) to adjust the tools it uses to manage interest rates. Already, in March 2021, the Fed raised capacity on its reverse repo program (RRP) to \$80 billion from \$30 billion per counterparty, to account for the large amount of cash that government MMFs hold, at \$4 trillion as of July 31, 2021 according to Crane Data. Similarly, in June 2021, the Fed increased the overnight RRP rate to 0.05% from 0.00% in an effort to keep interest rates above 0%. The increased capacity of the RRP has provided MMFs a venue to park excess cash, which otherwise may have gone into Treasury, Agency, and repo markets, and pushed interest rates lower. If MMF reforms cause significant flows into government MMFs, the Fed may be compelled to consider further actions.

**RRP Changes Prove Effective:** The Fed’s recent changes have led to a material increase in demand for the RRP, with total balances topping \$1.09 trillion as of August 12, 2021, from effectively no utilization a few months prior. As of July 30, 2021, MMFs held \$861 billion in the RRP, which was 83% of the program’s total utilization as of the same date. MMFs’ demand for the RRP is driven by the low interest rate environment and the recent rate increase for the program, a decrease in Treasury Bill (T-Bill) supply, and pandemic-driven inflows into government MMFs. Outstanding T-Bill supply peaked in June 2020, reaching over \$5 trillion outstanding, and declined by \$938 billion since then to July 31, 2021, according to SIFMA. Between February 28, 2020 and July 31, 2021, government MMFs have gained \$1.2 trillion in assets, according to CraneData. This mismatch between supply and demand has caused MMFs to push yields on Treasuries and other instruments to the lower end of the Fed’s target range, but the Fed’s recent changes have corrected this imbalance to a large degree. Fitch views MMF exposure to the RRP as commensurate with U.S. government risk, and therefore, there is no impact to ‘AAAmf’ ratings.

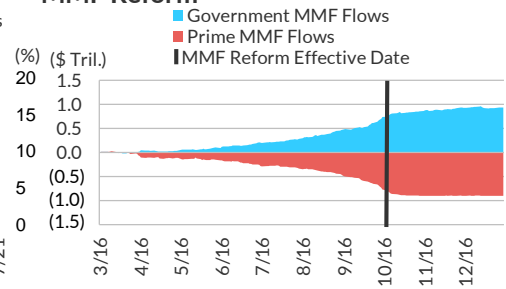
**MMF Reform Could Again Drive Government MMF Inflows:** U.S. MMF reforms currently under consideration could lead to large flows out of prime and into government MMFs, similar to 2016, when government MMFs gained \$884 billion between February and October at the expense of prime funds. Numerous reform proposals are being discussed, and the magnitude of MMF flows will depend on the outcome. If mild reforms are implemented, such as de-linking funds’ weekly liquidity levels from their ability to impose redemption fees or gates, this is unlikely to cause material prime fund outflows. However, if the outcome is to ban prime funds or introduce material structural changes, large prime fund outflows would be expected, with the money largely moving to the same fund managers’ government funds, based on historical experience. Under such a scenario, certain large government MMFs may be constrained in their ability invest such inflows in the Fed’s RRP, per the table to the right.

MMFs Increase RRP Usage



Source: Fitch Ratings, Crane Data.

Fund Flows Around the 2016 MMF Reform



Source: iMoneyNet.

## Top 10 Fund Exposures to RRP

| Fund  | Fund Type      | RRP Exposure (7/31/21) | Fund AUM | Remaining RRP Capacity |
|---|----------------|------------------------|----------|------------------------|
| Fidelity Government Cash Reserves                                 | Retail Gov.    | 56                     | 204      | 24                     |
| Fidelity Government Money Market                                  | Retail Gov.    | 54                     | 224      | 26                     |
| Morgan Stanley Institutional Liquidity Funds Government Portfolio | Inst. Gov.     | 50                     | 143      | 30                     |
| Fidelity Investments Money Market: Government Portfolio           | Inst. Gov.     | 49                     | 128      | 31                     |
| JPMorgan US Government Money Market                               | Inst. Gov.     | 46                     | 232      | 34                     |
| Federated Hermes Government Obligations                           | Inst. Gov.     | 44                     | 128      | 36                     |
| Dreyfus Government Cash Management                                | Inst. Gov.     | 36                     | 117      | 44                     |
| Wells Fargo Government Money Market                               | Inst. Gov.     | 33                     | 152      | 47                     |
| BlackRock Liquidity FedFund                                       | Inst. Gov.     | 26                     | 178      | 54                     |
| Northern Institutional Treasury Money Market                      | Inst. Treasury | 20                     | 76       | 56                     |

Source: Crane Data.



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