IMMFA Recommendations for Redemption Gates and Liquidity Fees

Redemption gates and liquidity fees are the most effective way of mitigating runs on MMFs
Fund managers have a fiduciary responsibility to treat all the investors in a mutual fund fairly and equally. Redemption gates and/or a liquidity fee are methods by which a fund manager, if experiencing difficulty due to extreme market circumstances, can control redemptions in order to ensure that all investors are treated fairly and that no 'first-mover' advantage exists.
Investors can access their cash but must pay a liquidity fee to ensure that all those investors who remain in the fund are no worse off because of the actions of the redeeming investor(s). This is similar in concept to the decrease in value an investor would face were they redeeming from a VNAV fund or selling directly held debt instruments.
Properly constituted, a liquidity fee will act as a "circuit-breaker" – a decelerant and not an accelerant of investor redemptions. The liquidity fee creates a last-mover rather than a first-mover advantage, ensuring that those investors who want to remain invested in a MMF can do so as they are protected from any impact of investors who do redeem during a period of stress.
Liquidity fees and redemption gates can be structured in a number of different ways. Based on feedback from the regulatory community and from investors in MMFs, IMMFA proposes the following:

Trigger based – The liquidity fee or redemption gate should be triggered if the one week liquidity level in a MMF falls below 10% of the assets under management in the MMF (against the proposed regulatory minimum of 20%). Basing the trigger on one week liquidity level ties the mechanism directly to the 'run' risk that policy makers are seeking to address. The 10% liquidity level gives the MMF sufficient time to repair and reduces the probability of the liquidity fee or gate being applied unnecessarily.

Mandatory implementation – Making it a mandatory requirement to apply a liquidity fee or redemption gate if the trigger is met removes any subjectivity, providing clarity to investors and reassurance to policy makers that the measures will be implemented. A mandatory implementation of a trigger based liquidity fee or redemption gate would not prevent the management company or board of directors of the MMF (referred to as 'senior management of the MMF' or 'MMF manager' by the MMFR) from applying a liquidity fee or redemption gate prior to the trigger being met if it was in the best interest of the shareholders of the MMF to do so.

Floating fee – The liquidity fee should reflect the estimated cost of raising liquidity to meet redemptions. Consistent with treating shareholders fairly, it should be based on the estimated cost to the whole MMF and not merely the cost of selling the most liquid asset in the MMF portfolio. Calculated this way the fee is punitive to neither redeemers nor the investors which remain in the MMF.

Cure terms – To ensure the liquidity fee and gate mechanism is transparent for investors, regulators and senior management of MMF managers, IMMFA recommends that;

- The liquidity fee may be lifted once the one week liquidity level has returned to the 20% minimum stipulated in the MMFR; and
- The redemption gate must be lifted within 10 business days.

It is important that limits are defined after which point the senior management of the MMF manager must determine an appropriate course of action for the MMF. In the case of action post the lifting of a redemption gate this could include, but is not limited to, a wind down of the MMF or a switch to VNAV. In the case of one week liquidity returning to 20% post the implementation of a liquidity fee, the senior management of the MMF manager may choose to maintain a liquidity fee if it believes it is in the best interest of all shareholders to do so.

IMMFA

INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

Suggested amendment to MMFR incorporating IMMFA's position on redemption gates and liquidity fees

Recital 45 &46

Text proposed by the Commission	Proposed Amendment
(45) **In order to be able to absorb day-to-day fluctuations in the value of a CNAV MMF's assets and allow it to offer a constant NAV per unit or share, the CNAV MMF should have at all times a NAV buffer amounting to at least 3% of its assets. The NAV buffer should serve as an absorbing mechanism for maintaining the constant NAV. All differences between the constant NAV per unit or share and the NAV per unit or share should be neutralized by using the NAV buffer. During stressed market situations, when the differences can rapidly increase, a procedure should ensure that the whole chain of management is involved. This escalation procedure should permit the senior management to take rapid remedy actions.** (46) **As** a CNAV MMF that **does not maintain the NAV buffer at the required level is not capable of sustaining a constant NAV per unit or share, it should be required to fluctuate the NAV and cease to be a CNAV MMF. Therefore, where despite the use of the escalation procedure the amount of the NAV buffer remains for one month below the required 3% by 10 basis points, the CNAV MMF should automatically convert into a MMF that is not allowed to use amortised cost accounting or rounding to the nearest percentage point**. If **before the end of the one month allowed for the replenishment** a competent authority has justifiable reasons demonstrating the in**capacity** of the CNAV MMF **to replenish the buffer**, it should have the power to convert the CNAV MMF into a MMF other than a CNAV MMF. **The NAV buffer is the only vehicle through which external support to a CNAV MMF can be provided.**	(45) ***In order to be able to mitigate client redemptions in times of severe stress, to give investors an effective choice of being able to invest in either VNAV or CNAV MMFs and to ensure CNAV MMF managers perform their duty in terms of treating all shareholders fairly, the CNAV MMF shall have in place redemption gate and/or fee provisions to enable MMF managers to ensure that "early redeemers" do not in periods of extreme conditions redeem leaving other investors unfairly exposed to the then prevailing market conditions. Redemption gates and liquidity fees mitigate client redemptions from CNAV MMF in times of stress while still enabling CNAV MMF investors to manage their own liquidity.*** ***Redemption gates and/or fees should not apply to Government Liquidity CNAV MMFs as these are regarded by investors as a safe haven during stressed market conditions*** (46) A CNAV MMF ***that is not able to meet the minimum amount of weekly maturing assets shall apply a redemption gate or fee***. ***If a redemption gate has been applied it must be lifted within 10 business days. Subsequent action may include a wind down of the CNAV MMF or its conversion to a VNAV MMF. If a fee is implemented it must remain in place at least until the MMF meets the minimum weekly liquidity requirements set out in this Regulation. The senior management of the MMF manager may choose to maintain the fee if it believes it is in the best interest of all shareholders to do so.*** If a competent authority has justifiable reasons demonstrating the in***ability*** of the CNAV MMF ***to meet the liquidity requirements set out in this Regulation on an ongoing basis***, it should have the power to ***request the MMF manager to either*** convert the CNAV MMF into a MMF other than a CNAV MMF ***or to liquidate the CNAV MMF.***

Article 29 - 34

Text proposed by the Commission	Proposed Amendment
Whole text	***Delete existing text except 29.1*** ***29.1. A MMF shall not use the amortised cost method for valuation or advertise a constant NAV per unit or share or round the constant NAV per unit or share to the nearest percentage point or its equivalent when the NAV is published in a currency unit unless it has been explicitly authorized as a CNAV MMF.*** ***29.2 New*** ***By way of exception to this, the assets of a VNAV MMF may be valued by amortised cost under the conditions outlined in Article 26.5*** ***29.3 New*** ***The CNAV MMF shall have in place redemption gate and/or fee provisions. The senior management of the CNAV MMF manager or management company shall implement a redemption gate or fee once the level of weekly liquid assets falls below 10%.*** ***The level of the fee will vary over time to reflect the estimated cost to the MMF of raising liquidity to meet redemptions with the aim of ensuring the cost is allocated fairly across all investors.*** ***A redemption gate shall be lifted within 10 business days of its application. Subsequent action may include a wind down of the CNAV MMF or its conversion to a VNAV MMF.*** ***A liquidity fee shall be applied at least until the CNAV MMF meets the minimum weekly liquidity requirements set out in this Regulation. The senior management of the CNAV MMF manager or management company may choose to extend the fee if it believes this is in the best interest of all shareholders.*** ***The senior management of the MMF manager or management company may implement a redemption gate or fee before the trigger is met if it believes it is in the best interest of shareholders to do so.*** ***Redemption gates and/or fees shall not apply to Government Liquidity CNAV MMFs.***