Fed introduces Money Market Mutual Fund Liquidity Facility

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Original post here.

Money market mutual funds ("money funds") are common investments for families, businesses, pension funds, municipalities and others. On March 18th, the Federal Reserve announced that it would implement a Money Market Mutual Fund Liquidity Facility (MMLF) to enable money funds to meet redemption requests and support the overall flow of credit to businesses and households. Money funds are significant investors in commercial paper, which many businesses rely on as a source of funding.

Under the MMLF, the Federal Reserve Bank of Boston will make nonrecourse loans to eligible financial institutions (including depository institutions, bank holding companies and US branches of foreign banks) anywhere in the country to facilitate the purchase of high-quality assets from eligible prime money funds. Loans will be for no more than 12 months or the term of the assets purchased, if less, and secured by the purchased assets. Assets eligible for purchase include: US Treasuries, agency securities, and highly rated unsecured and asset-backed commercial paper (ABCP) issued by US issuers. For additional details see the MMLF Term Sheet.

Participating financial institutions will not bear any credit or market risk from the purchased assets. For this reason, under a proposed rule modification, federal bank regulators will not require them to hold regulatory capital against these assets.

The Fed established the MMLF under Section 13(3) of the Federal Reserve Act, with approval of the Treasury Secretary (see here). Section 13(3) allows the Fed to lend to any "individual, partnership or corporation" when the Federal Reserve Board determines there are "unusual and exigent circumstances". Although the MMLF loans will be made to depository institutions, they are for the benefit of money funds. Using the Exchange Fund, the Treasury has provided $10 billion as credit protection to the Fed.

The MMLF is similar to the Asset-backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) operated by the Fed from late 2008 through 2009. That facility funded $217 billion in purchases of commercial paper from mutual funds at a time when funds were experiencing significant withdrawals and when the commercial paper market was also under distress. It enabled money funds to access liquidity without having to sell assets into illiquid markets and helped fostered liquidity in the ABCP market and money markets more generally.

The MMLF will fund a broader set of asset purchases than the AMLF did but is similarly structured. Although it operated alongside other programs aimed at the same stresses (such as the Commercial Paper Funding Facility, a version of which the Fed reintroduced on March

17th), market observers believe the AMLF helped stabilized outflows from money funds and provided reassurance to investors and issuers that they would be able to rollover their commercial paper at maturity. See the Fed's description of the AMLF here.