

Preventing Runs with Redemption Fees" (joint with Xuesong Huang)

Abstract

We develop a model for evaluating policy proposals that aim to prevent runs on money market mutual funds (MMFs) and related intermediation arrangements. We first study policies that impose a redemption fee when the fund's liquid assets fall below a threshold level, similar to the reforms adopted in the U.S. in 2014. We show that such policies are often susceptible to a preemptive run in which investors rush to withdraw before the fees are imposed, in line with events at the onset of the Covid crisis in March 2020. We then study policies that impose a fee based on current redemption demand, even in normal times. We show that such policies are more effective at preventing runs, and we derive the best run-proof redemption fee policy. We show that this policy can have surprising features, such as setting the fee as a non-monotone function of redemption demand. Our framework indicates the new MMF reforms adopted in 2023 are an improvement over the previous round but may still be susceptible to preemptive runs. We discuss the implications of our results for further reforms to MMFs and for stabilizing mutual funds more broadly.