# Money Market Mutual Fund Reform: Opening Statement at the SEC Open Meeting

by

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Good morning, Chair White and Commissioners Walter, Aguilar, Paredes, and Gallagher. Today I am pleased to present for your consideration the recommendations of the SEC's Division of Investment Management to amend certain of the rules governing money market mutual funds. Chair White, thank you for so ably taking the reins on this project and keeping us on track to get where we are today. I would also like to thank Commissioner Walter for her very effective leadership and tireless involvement on this project while she was Chair and her continued contributions since then. Thank you to each of Commissioners Aguilar, Paredes, and Gallagher for your engagement in this rulemaking process and your invaluable thoughts and input.

I'd like to primarily discuss the background of our reform recommendations, as well as the staff's process in drafting these recommendations. Then Craig Lewis, Director of the Division of Risk, Strategy, and Financial Innovation will provide some additional remarks about the economic analysis of the recommendations, and Brian Johnson from the Division of Investment Management will describe the recommendations in more detail.

Money market mutual funds are different from other types of mutual funds because they seek to maintain a stable $1.00 share price. Rule 2a-7 under the Investment Company Act allows money market mutual funds to maintain this stable $1.00 share price by allowing them to use certain pricing and valuation conventions. In return, the funds must adhere to certain credit quality, maturity, liquidity, and diversification requirements designed to reduce the likelihood of fluctuations in their value. Money market mutual funds are popular investment vehicles for both retail and institutional investors, in part, because they are a convenient way for them to manage their cash that is not invested in the market. In addition, these funds purchase short-term debt securities from issuers, providing a valuable source of funding.

However, as was made clear during the 2008 financial crisis, money market mutual funds can be susceptible to heavy redemptions during periods of market stress. This can create problems for the fund experiencing the redemptions because it may not have enough liquidity to meet redemptions and may have to sell securities at distressed prices. These redemptions can also potentially lead to broader issues in the money market mutual fund industry if redemptions become widespread. Money market mutual funds are susceptible to such redemptions in part because their stable $1.00 share price can create an incentive for investors to redeem shares ahead of other money market mutual fund investors when there is a risk of loss in a fund's portfolio, because early redeemers will receive the $1.00 share price even if the fund has experienced losses. In addition, investors may redeem quickly to gain the benefit of the fund's liquidity. In so doing, these investors can impose costs on the fund and the remaining shareholders that are not borne by the redeeming shareholders because any portfolio losses are not reflected in the stable $1.00 share price and are concentrated among a smaller asset base, which can cause the fund to re-price its shares below $1.00 a share.

In 2010, the Commission adopted amendments to rule 2a-7 of the Investment Company Act. These amendments were designed to make money market funds more resilient to losses by reducing the interest rate, credit, and liquidity risks of fund portfolios, and by increasing disclosure of fund portfolios. Since 2010, SEC staff has continued to monitor and study money market mutual funds. In November 2012, the SEC's Division of Risk, Strategy, and Financial Innovation delivered an extensive economic study to the Commission addressing a series of questions about money market mutual funds posed by Commissioners Aguilar, Paredes, and Gallagher. This study considered and conducted analyses of, among other things, investor redemptions from money market mutual funds during the 2008 financial crisis, and the effects of the Commission's 2010 money market mutual fund reforms.

The recommendations for further reform that we present to you today stem from careful consideration of funds' risks, and are the culmination of a long process of review and analysis, including review of the Division of Risk, Strategy, and Financial Innovation's study. These recommendations are the result of regular and continuous dialogue with every one of you on the Commission, as well as close collaboration with other Divisions here at the SEC.

The recommendations we are presenting today are designed to protect investors and promote market stability, and were designed with four overarching policy goals that we formulated with you. These goals are:

> First, to address money market mutual funds' vulnerability to heavy redemptions;
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> Second, to improve money market mutual funds' ability to manage and diminish potential contagion resulting from high redemption levels;
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> Third, to increase the transparency of money market mutual funds' risks and risk management practices; and
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> Finally, but equally importantly, to preserve the current benefits of money market mutual funds for investors to the greatest extent possible.

Chair White, as you outlined, our recommendations include two alternative reform approaches. The first alternative would require prime institutional money market mutual funds to price and transact at a floating NAV. Under this alternative, retail funds and government funds would be exempt from the floating NAV requirement. The second alternative would generally require money market mutual funds to impose liquidity fees if a fund's liquidity levels fall below a specified threshold, and also would permit the fund to temporarily suspend redemptions when this same liquidity threshold is reached.

Each of these alternatives addresses money market reform in a careful, targeted manner. Both alternatives are designed to address the risks of money market mutual funds while maintaining the current ability of money market mutual funds to function as an effective and efficient cash management tool for investors. Each alternative has its own merits and potential drawbacks, and costs and benefits, but each option also addresses the risks related to heavy redemptions from funds.

We also recommend that you include in the proposal a request for comments on the potential for combining the two alternatives at adoption into a single reform of the product. Although the two primary alternatives are designed to achieve many of the same goals, by their nature they would do so to different degrees and with different tradeoffs. We believe that if you were to combine the two proposals, such a combination may in some ways improve on each alternative standing alone. However, the combination could also result in certain drawbacks and impose additional costs. We recommend that you request comments from the public on whether the two alternatives should be combined, and if so, how the combination should be designed to most effectively protect investors, preserve capital formation, promote market stability, and maintain the benefits of the product.

Finally, we recommend that you propose a number of other, additional reforms to money market mutual funds to increase their resiliency and transparency. Specifically, we recommend that you propose reforms that would enhance the disclosure of money market mutual fund risks and risk management practices, require disclosure of material events such as sponsor support, require more comprehensive stress testing procedures, and include tighter portfolio diversification requirements. We also recommend that you require investment advisers to certain unregistered liquidity funds, which can resemble money market mutual funds, to provide additional information about those funds to the Commission.

The process of creating the recommendations before you today, as well as their substance, represent a significant step in the multi-year journey towards money market mutual fund reform. Every stage of the process of developing the current recommendations involved close collaboration between the Division of Investment Management and the Division of Risk, Strategy, and Financial Innovation, and with each of you. These collaborations, as well as with the Office of the General Counsel and so many other Divisions and Offices within the Commission, is illustrative of the careful consideration of risks, costs, and benefits that characterized the recommendations' development. The Division of Investment Management hopes to continue this collaborative approach to rulemaking in which we solicit everyone's ideas as we move forward with our upcoming rulemaking priorities.

The Division believes that this process has produced a release that has an in-depth discussion of all of the reform options and explains why we are recommending the reform options that are in the proposal. The proposing release should provide a comprehensive base for a thorough public discussion of the reform options. We look forward to public comment on the proposal.

Chair White, I would like to echo my thanks to the staff you mentioned in your opening statement, including my staff in the Division of Investment Management. In particular, I would like to acknowledge Sarah ten Siethoff for her dedicated leadership, excellent lawyering, and her steadfast personal commitment to this project. I would also like to thank the staff in the Division of Risk, Strategy, and Financial Innovation, the Office of the General Counsel, the Division of Trading and Markets, the Division of Corporation Finance, the Division of Enforcement, the Office of the Chief Accountant, the Office of Compliance, Inspections, and Examinations, and the Office of International Affairs. Our recommendations have benefited greatly from their thoughtful contribution, guidance, and advice.

Now Craig Lewis, Director of the Division of Risk, Strategy, and Financial Innovation and Brian Johnson from the Division of Investment Management will provide some additional remarks about the economic analysis of the money market mutual fund reform options that we are recommending that you propose today, as well as the details of those options. Thank you.