Statement at SEC Open Meeting – Proposed Rules Regarding Money Market Funds

by

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Thank you, Chair White. I would like to join my colleagues in thanking the staff for all of the hard work that went into today's proposing release. I would like to extend a special thank you to Norm Champ, Craig Lewis, Kathleen Hanley, Sarah ten Siethoff, Jennifer Bethel, Brian Johnson, and Thoreau Bartmann for their efforts leading up to today, and I would also like to thank our former colleague, Eileen Rominger, for all of the wise counsel that she provided me last year on the issues underlying this rulemaking.

Diane [Blizzard], I'd like to single you out here, I am sure much to your chagrin. There is one aspect of being a Commissioner that is truly both a blessing and a curse, and that is the requirement that we vote on all issues from all Divisions. It is a curse because it takes us out of our comfort and knowledge zone. It is a blessing, though, because we get to work with all of the staff from all of the Divisions and Offices. This is the first significant rulemaking I have gotten to work with you on, Diane, and I can tell you and everyone here that all of the wonderful things I have heard about you over the years are true. Thank you for what you do.

The path to today's proposal has been a long and winding one. Indeed, as I sit here today, it's hard to believe that we have produced such an excellent proposal given where this agency stood last August. For me, it is important to explain the evolution of this proposal and how I ultimately became comfortable moving forward with amendments to our money market fund rules.

Far too much has been said and written – with far too little accuracy - about the fundamentally flawed draft proposal on money market fund reform that was championed last year by the then-Chairman. In contrast with today's proposal, last year's proposal – through no fault of the staff's – was drafted without the input of the Commissioners and presented to the Commission as an inviolate fait accompli. Indeed, we were given the proposal only after it had been fully baked and blessed by other agencies.

Moreover, despite requests from three Commissioners for our economic experts to conduct a study examining several key issues prior to drafting a rulemaking proposal, the staff was not directed to do so. Only after last year's fundamentally flawed draft proposal had been rejected by a majority of the Commissioners, and after the decision had been made to abdicate responsibility for MMF regulation to the FSOC, did the staff receive such authorization. If the staff had been authorized and directed to study these issues earlier and to engage the full Commission in the drafting process as it should with every rulemaking proposal, we could have issued today's proposal last year and might be discussing its adoption today. Any claims to the contrary are disingenuous. Indeed, given the substance of today's proposal, it appears that the Commission could have pursued the floating NAV reform much earlier. My predecessor Commissioner Kathleen Casey voted against the 2010 amendments because, in part, they did not make structural changes such as including a floating NAV requirement.[1]

Turning to today's proposal, as I have previously stated publicly, I believe, and have consistently believed, that a properly tailored and implemented floating NAV will both address many of the problems experienced in 2008 and make clear to investors and policymakers that MMFs are not bank products, but rather investment products best regulated by the SEC. However, despite these benefits, I am not convinced that floating the NAV is a guaranteed "fix" for all of the problems experienced in 2008. I believe that it is also critical for MMF boards to have the authority to suspend redemptions temporarily, a procedure commonly known as "gating."

Floating the NAV should better inform investors about the risks associated with investing in MMFs and will enhance the transparency of these products, thus reducing the incentive to run. But the only way to ensure that a run is stopped in its tracks is to permit gating. And the truth is that a form of gating already exists today, though fund investors have not been made properly aware of it. Before 2010, the suspension of redemptions by MMFs was generally prohibited except in certain very limited circumstances. In 2010, the Commission took a step towards true gating when it approved rule amendments that specifically authorized the suspension of redemptions in the context of an irrevocable decision to liquidate and wind down a MMF. It only makes sense for us to expand that authority and, importantly, to ensure that the potential lack of liquidity in a gated fund is thoroughly disclosed to investors. For me, the combination of floating NAV and gating, which is one of the regulatory options we are proposing today, is the most robust plan for strengthening these important investment products.

To those who followed the debate over last year's proposal in public speeches and in the media, which is where most of the conversation took place, it would be reasonable to wonder why I am supporting floating NAV today when I was not willing to support the floating NAV proposal in last year's package. The answer is that not all floating NAV proposals are equal. Today's floating NAV proposal, which takes up 106 pages of the proposing release, is comprehensive, sophisticated, and thoughtful. It identifies and attempts to solve key issues raised by floating the NAV. In contrast, and again through no fault of the staff's, last year's 33-page discussion of floating NAV was not a serious proposal. As a result, it was unfocused, unrefined, and, ultimately, un-implementable. It mentioned in passing, but did not address, important tax consequences that would be raised by floating the NAV. It mentioned, but did not analyze or try to resolve, crucial accounting issues that would be raised by floating the NAV.

To illustrate my point, this is what last year's proposal said about these accounting issues: "Current U.S. GAAP includes investments in money market funds as an example of a cash equivalent, but this guidance may not contemplate money market funds using floating NAVs." In dramatic contrast, and emblematic of the significant departure from last year's approach, today's proposal says the following about these accounting issues: "We believe the adoption of floating NAV alone would not preclude shareholders from classifying their investments in money market funds as cash equivalents because fluctuations in the amount of cash received upon redemption would likely be insignificant and would be consistent with the [GAAP] concept of a 'known' amount of cash." Thus, unlike last year's proposal, today's proposal not only tees up hard issues, it also tries very hard to resolve them. Of course, we will need the benefit of public comment on the proposals, and there is still much work to be done both during and after the comment period before we can make a decision regarding adoption of any final rule. But I can say with confidence that we are light-years ahead of last year's failed proposal.

Indeed, I believe last year's draft proposal was never intended to be serious about floating the NAV. Floating NAV was included in the proposal merely as a stalking horse intended to intimidate MMF stakeholders into accepting the other initiative in last year's proposal, the so-called "capital buffer." It is critically important to me that today's proposal does not include the capital buffer alternative. I say so because last year's draft proposal contained 125 pages discussing a buffer proposal that had nothing to do with "capital" in any regulatory sense of that word, and which was therefore a misnomer. It purported to respond to the calamitous events of 2008, but it was plainly inadequate for that task, as our economists confirmed in their study. It would not have stopped mass redemptions in 2008. It would not have prevented MMFs from breaking the buck. It would, however, have given investors – especially retail investors, whom we are supposed to protect – a false sense of safety regarding their investments. It became clear to me early on in this process that the only real purpose for the proposed buffer was to serve as the price of entry into an emergency lending facility that the Federal Reserve could construct during any future crisis – in short, the "buffer" would provide additional collateral to facilitate a Fed bailout for troubled MMFs.[2] And yet that purpose was not discussed anywhere in last year's release.

And our economic analysis demonstrates that we should not be pursuing a capital buffer proposal. As discussed in today's proposing release, our economists believe that in order to act as a bulwark against default risk or run risk, a buffer would have to be so large that it would not be economical for MMFs to continue to operate. And, conversely, if the buffer was small enough to be economical, then it would provide no protection against events like the ones experienced in 2008. This is not news. Indeed, variations of the capital buffer concept have been widely discussed in the public domain, and it is fair to say that the concept has been generally panned. A buffer would either be too small to be effective, or it would be large and so harmful to the economics of MMFs that they would more or less cease to exist as an option for investors. And the addition of a holdback, or "minimum balance at risk," would have done nothing except to ensure that MMFs would be useless to investors and to prompt an exodus of investors from the funds. I guess that getting all of your investors to run now is one way to prevent a run later!

Today's proposal is a very good one. There are other aspects of MMF regulation that I would have liked to tackle today, such as the removal of references to credit ratings in the Commission's MMF rules – a critical piece of unfinished business that would be directly responsive to the financial crisis. But I think today's proposal is both sound and of appropriate scope. Thanks to the Commission's current and recent leadership, as well as the efforts of a highly professional and capable staff, we have been able to work together to create today's proposal, a proposal that is tailored to the real facts about money market funds.

Before I conclude, I want to recognize the contributions of my colleagues on the Commission and express my gratitude to them. First, Chair White, you deserve tremendous credit for bringing this proposal across the finish line just weeks after you started here. Commissioner Walter, during your chairmanship, you were the guiding hand behind today's proposal as it took meaningful shape.

And, finally, I want to recognize the incredible value added to this process by my colleagues Commissioners Paredes and Aguilar. Everyone's insights are represented in this proposal, as is the excellent work produced in the study that Troy, Luis and I demanded. But it has been a special pleasure to work with Troy and Luis on these issues. As we made clear in our statement last year, Troy and I worked hard to propose a gating proposal that was, unfortunately, summarily dismissed at the time, but which features prominently today.

And Luis, given his expertness in this area, has been a force on these issues, rightfully pointing out at an early stage of the process that the agency had no clue where MMF assets would migrate if investors were to reject MMFs as a consequence of our reforms. This is a critical issue for investors and the capital markets, and by raising it – and demanding more study of it – Luis has caused this agency to think harder about the potential unintended consequences of our proposals. This analysis is reflected both in the economists' study and in today's proposal. So, thank you all, and it has been a pleasure working with you on this rulemaking.

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1 See Statement of Commissioner Kathleen L. Casey on Proposing Release, Money Market Fund Reform (January 27, 2010), available at http://www.sec.gov/news/speech/2010/spch012710klc-mmf.htm ("While I appreciate many of the reform proposals set forth in today's adopting release, such as the enhancements to liquidity and maturity, they simply do not go far enough…. Regrettably, my vote on the release today necessarily presumes that this is the only reform we will undertake despite discussion, as the Chairman has endorsed, of a more fundamental reevaluation of rule 2a-7 in the context of a second rulemaking later this year. Because I cannot be sure when or whether we will have an opportunity to address the underpinnings of the rule and because I believe these issues are of critical importance now, I cannot, in isolation, support the limited measures we are taking today…. We must more fundamentally rethink how [money market funds] are regulated. If we are to address these concerns, one of two logical paths lies ahead[, one of which is that money market funds] should move to a floating NAV.").

2 Cf. Comment Letter of Jeffrey N. Gordon at 9 (Feb. 28, 2013) (File No. FSOC-2012-0003), available at http://www.regulations.gov/#!documentDetail;D=FSOC-2012-0003-0131).