U.S. Securities and Exchange Commission

Statement of SEC Chairman Mary L. Schapiro on Money Market Fund Reform

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Washington, D.C., Aug. 22, 2012 — Securities and Exchange Commission Chairman Mary Schapiro today made the following statement:

> Three Commissioners, constituting a majority of the Commission, have informed me that they will not support a staff proposal to reform the structure of money market funds. The proposed structural reforms were intended to reduce their susceptibility to runs, protect retail investors and lessen the need for future taxpayer bailouts.
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> I -- together with many other regulators and commentators from both political parties and various political philosophies -- consider the structural reform of money markets one of the pieces of unfinished business from the financial crisis.
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> While as Commissioners, we each have our own views about the need to bolster money market funds, a proposal would have given the public the chance to weigh in with their views as well. However, because three Commissioners have now stated that they will not support the proposal and that it therefore cannot be published for public comment, there is no longer a need to formally call the matter to a vote at a public Commission meeting. Some Commissioners have instead suggested a concept release. We have been engaging for two and a half years on structural reform of money market funds. A concept release at this point does not advance the discussion. The public needs concrete proposals to react to.
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> The declaration by the three Commissioners that they will not vote to propose reform now provides the needed clarity for other policymakers as they consider ways to address the systemic risks posed by money market funds. I urge them to act with the same determination that the staff of the SEC has displayed over the past two years.
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> As we consider money market funds' susceptibility to runs, we must remember the lessons of the financial crisis and the history of money market funds. And, we must be cognizant that the tools that were used to stop the run on money market funds in 2008 no longer exist. That is, there is no "back-up plan" in place if we experience another run on money market funds because money market funds effectively are operating without a net.
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> One of the most critical lessons from the financial crisis is that, when regulators identify a potential systemic risk - or an industry or institution that potentially could require a taxpayer bailout - we must speak up. It is our duty to foster a public debate and to pursue appropriate reforms. I believe that is why financial regulators both past and present, both Democrats and Republicans, have spoken out in favor of structural reform of money market funds. I also believe that is

why independent observers, such as academics and the financial press -- from a variety of philosophical ideologies -- have supported structural reform of money market funds, as well.

The issue is too important to investors, to our economy and to taxpayers to put our head in the sand and wish it away. Money market funds' susceptibility to runs needs to be addressed. Other policymakers now have clarity that the SEC will not act to issue a money market fund reform proposal and can take this into account in deciding what steps should be taken to address this issue.

History and Background

It's been a long and deliberative process that led us to the point we are at today.

Money market funds, as we know them, actually are not permitted under existing federal securities statutes. Instead, they exist as a result of a special exemption granted by the SEC three decades ago. This exemptive rule, known as rule 2a-7, allows money market funds to seek to maintain a stable $1.00 net asset value by using penny rounding and amortized cost accounting. As a result of this exemption, these funds do not have to comply with the mark-to-market valuation standards required for all other mutual funds.

In exchange, money market funds relying on rule 2a-7 must follow strict limitations on their investments.

Over the years, money market funds fostered a strong sense of stability as they maintained a stable $1.00 NAV. Before long, retail investors were using them as substitutes for checking accounts -- and institutional investors were using them as vehicles for their cash management.

Between 1983 and 2008, only one small money market fund fell far enough below the $1.00 NAV that it broke the buck, but because of its size, the impact from that event did not spread to other money market funds or the broader market. During that period, however, numerous sponsors of money market funds supported the funds' stable $1.00 NAVs by purchasing out troubled securities at above-market values; injecting cash infusions into the funds; and otherwise engaging in capital support of their money market funds.

Unfortunately, the sense of stability this created led to what I believe to be a false sense of security, masking risks that became all too apparent during the financial crisis. When the Reserve Primary Fund broke the buck in the fall of 2008, this stability was shattered.

In a matter of days, panicked investors had redeemed not only massive amounts from the Reserve Fund, but more than $300 billion from prime money market funds across the industry. The short term credit markets froze. And, financial institutions and operating companies worldwide were unable to effectively fund their daily operations.

To stop the growing damage, the Treasury Department stepped in by temporarily guaranteeing investments in money market funds. This was an unprecedented action that put taxpayers on the hook for the performance of an investment product.

The temporary federal guarantee was supplemented by Federal Reserve

Board liquidity facilities, which also provided unprecedented assistance to money market funds.

In short, every taxpayer in the nation found themselves a partial insurer of a $multi-trillion investment product.

Money Market Funds' Structural Issues

While the events of the 2008 financial crisis dramatically exposed the risks presented by money market funds, it also highlighted that the risks stem from flaws inherent in the structure of money market funds. In particular, most of the risks resulted from the valuation standards and stable NAV that are permitted to exist by SEC rule, without any capital or asset cushion to back them up.

- ***First, money market funds have no ability to absorb a loss above a certain size without breaking the buck.*** We saw that first hand with the Reserve Primary Fund, where just over 1% of that fund's assets were held in commercial paper of Lehman Brothers. When Lehman Brothers declared bankruptcy, its commercial paper became worthless, the fund broke the buck, investors began to flee the fund, and other funds began to experience high rates of redemptions as a result.

- ***Second, investors of money market funds have every incentive to run at the first sign of a problem.*** We saw this phenomenon play out in the week of September 15, 2008 when over $300 billion was withdrawn from prime money market funds. Under the "first-mover advantage," those who redeem first, get out with their full $1.00 invested, even if the fund's assets are worth slightly less. This leaves all the other investors holding the bag -usually the slower moving retail investors who can lose both value and access to their money. They lose the value when the fund reaches a mark-to-market NAV of 99-and-a-half cents and breaks the buck. And they lose access, for an unknown period, since fund boards are now permitted to suspend redemptions and liquidate a fund if it breaks the buck.

This inability to absorb a loss in value of a portfolio security and the incentive to run at the first sign of a problem are the two structural issues we were seeking to address with the proposals under consideration by the Commission. These are issues that are inherent in the structure of money market funds which came to the fore in the financial crisis, but undoubtedly are still present.

The fear of breaking the buck and triggering a run is perhaps one reason why fund managers, in hundreds of instances, have sought some type of relief to bolster their funds' financial condition and prevent the breaking of a buck.

Several entities - from Moody's to the Federal Reserve to our own staff - have spelled out this fact. Indeed, based on our staff's tabulation, there have been more than 300 such instances, dating back to the 1980s. This figure represents those occasions where fund sponsors requested relief or otherwise notified us that they provided sponsor capital support to their funds because of a troubled security holding or a need to address diminished value or extraordinary redemptions in a money market fund.

As we all know, though, and as was evident in the Reserve Primary

Fund case, there is no legal obligation for a fund's sponsor to support its fund, and there is absolutely no certainty that every fund sponsor with a problem in its money market fund will be able to provide capital support to the fund.

Reform Alternatives

That is why we were considering alternative proposals that would address these two structural issues in different ways.

The two alternatives:

- ***First, that money market funds float the NAV and use mark-to-market valuation like every other mutual fund.*** This would underscore for investors that money market funds are investment products and that any expectation of a guarantee is unwarranted. In such a scenario, investment losses in money market fund portfolios could be both absorbed and reflected in the price - as would gains for that matter. Similarly, while the incentive to run may not be reduced entirely, the "cliff" effect of redeeming at $1.00, or getting stuck with a loss and no immediate access to one's assets would no longer exist.

- ***Second, and alternatively, a tailored capital buffer of less than 1% of fund assets, adjusted to reflect the risk characteristics of the money market fund.*** This capital buffer would be used to absorb the day-to-day variations in the value of a money market fund's holdings. To supplement that capital buffer in times of stress, it would be combined with a minimum balance at risk requirement. That requirement would enable investors to redeem up to 97% of their assets in the normal course as they do today. However, it would require a 30-day holdback of the final 3% of a shareholder's investment in a money market fund. That holdback would take a so-called "first-loss" position and could be used to provide extra capital to a money market fund that suffered losses greater than its capital buffer during that 30-day period. The result is that remaining investors would not be harmed by a redeeming investor's full withdrawal and the incentive to redeem fully and quickly at the first sign of trouble would be diminished.

I believe these proposals have merit, address the two structural issues identified, and deserved to see the light of day so that we could receive public feedback.

The Reform Process

Development of these proposals was thorough and considered. In June 2009, shortly after the financial crisis and my arrival at the Commission, the Commission proposed an important first round of reforms to boost the resilience of money market fund portfolios. The Commission adopted those reforms in January of 2010. The reforms shortened maturities, improved credit qualities, and for the first time imposed liquidity requirements for money market funds. The reforms were based in large part on the March 2009 report of the ICI's Money Market Fund Working Group. This first round of reforms also imposed new disclosure requirements regarding money market fund portfolios and shadow NAVs. Those disclosures have been very valuable to both the SEC and to investors as we monitor money market fund portfolios.

But, when the Commission proposed the first stage of money market fund reforms in 2009, it also requested comment on additional structural reforms: namely whether to mandate a floating NAV and whether to require redemptions in kind. In other words, the Commission made clear that the first round of reforms in 2010 were a first step and that additional structural reforms were expected to follow as a second step. In fact, I specifically said as much at the time.

Thereafter, in November 2010, the Commission requested comment on structural reform options discussed in the Money Market Fund Report issued by the President's Working Group -- a precursor to the Financial Stability Oversight Council. After reviewing those comments, the SEC hosted a May 2011 Roundtable on Money Market Funds and Systemic Risk. The roundtable included voting members from FSOC or their designee as well as fund industry representatives, investors, academics, foreign regulators and industry observers.

Following the roundtable, our staff in consultation with staff from the Treasury and the Federal Reserve, met with various fund industry representatives to discuss multiple structural reform options and we received even more ideas worthy of pursuing. And we continued to collect public comment throughout this long process.

Once the staff narrowed money market reform options, they refined those options, obtained suggestions for additional areas of public comment and prepared a proposal that is shaped and strengthened by economic analysis. The draft release presented to the Commissioners requests comment on multiple alternative approaches to money market fund reform, including liquidity fees and gates - all with a view of furthering the public debate.

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http://www.sec.gov/news/press/2012/2012-166.htm
