Opening Statement at the SEC Open Meeting

by

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This is an open meeting of the Securities and Exchange Commission on June 5, 2013.

Today, the Commission will consider proposals that would reform the way money market funds operate in order to make them less susceptible to runs.

As many people know, money market funds are investment vehicles that hold a pool of high-quality, short-term securities. In the early 1980s, the Commission provided money market funds with an exemption making them distinct from mutual funds and certain other investment products. That exemptive rule (Rule 2a-7) allowed these funds generally to maintain a stable share price of $1.00 instead of changing their share prices according to the market value of the securities held by the fund.

The industry has changed substantially since that time. Money market funds are now a significant piece of the nation's financial system. Over the years, money market funds have become a popular investment product for both retail and institutional investors. They also have become an important provider of short-term financing to corporations, banks and governments. All told, money market funds hold nearly $3 trillion in assets, the majority of which are in institutional funds.

While money market funds have thus long served as an important investment vehicle, the financial crisis of 2008 highlighted the susceptibility of these products to runs. In September of that year - at the height of the financial crisis - a money market fund called the Reserve Primary Fund "broke the buck" - a term used when the value of a fund drops and investors are no longer able to get back the full dollar they put in.

Within the same week of that occurrence, investors pulled approximately $300 billion from other institutional prime money market funds. The contagion effect was rapid. The short term credit market dried up, and corporations had trouble borrowing to run their businesses. This reaction contributed to the significant disruption that already was consuming the financial system.

To stop this run, the government stepped in with unprecedented support in the form of the Treasury temporary money market fund guarantee program and Federal Reserve liquidity facilities.

In the aftermath of that experience, the Commission - in 2010 - adopted a series of reforms that increased the resiliency of money market funds. But, as the Commission stated at that time, those reforms were only a first step. Today's proposal takes the critical additional step of addressing the stable value pricing of institutional prime funds - at the heart of the 2008 run - and proposing methods to stop a money market fund run before such a run becomes a systemically destabilizing event.

It has been a journey to get to this point. Commission staff has spent literally years studying different reform alternatives and performing extensive economic analysis in arriving at these recommendations.

These proposals are important in and of themselves and because they advance the public debate that will shape the final rules to address one of the most prominent events arising from the financial crisis.

Today's proposal contains two alternative reforms that could be adopted separately or combined into a single reform package to address run risk in money market funds.

Floating NAV

The first proposed alternative would require that all institutional prime money market funds operate with a floating net asset value (NAV). That is, they could no longer value their entire portfolio at amortized cost and they could not round their share prices to the nearest penny. The set "dollar" would be replaced by a share price that actually fluctuates, reflecting the changing values in these money market funds.

This floating NAV proposal specifically targets the funds where the problems during the financial crisis occurred: institutional, prime money market funds.

Retail and government money market funds - which have not historically faced runs in even the worst of times - would be exempt from the proposed floating NAV requirement.

This approach would thus preserve the stable value fund product for those retail investors who have found it to be convenient and beneficial. It also would allow municipal and corporate investors to have access to government money market funds - a stable value product - if they need it, although it would be a product that holds federal government securities as opposed to the higher-yielding investments of a prime fund.

We are soliciting commenters' views regarding the impact of targeting the floating NAV reform to institutional prime funds and whether government and retail money market funds also should operate with a floating NAV, as well as commenters' views regarding whether today's proposal would effectively differentiate retail funds from institutional funds by imposing a $1 million redemption limit. These and other important questions are specifically posed in the proposal.

I believe the floating NAV reform proposal is important for a number of reasons:

- First, by eliminating the ability of early redeemers to receive $1.00 - even when the fund has experienced a loss and its shares are worth somewhat less - this proposal should reduce incentives for shareholders to redeem from institutional prime money market funds in times of stress.
- Second, the proposal increases transparency and highlights investment risk because shareholders would experience price changes as an institutional prime money market fund's value fluctuates.

- And, third, the proposal is targeted, by focusing reform on the segment of the market that experienced the run in the financial crisis.

Fees & Gates

The second proposed alternative seeks to directly counter potentially harmful redemption behavior during times of stress.

Under this alternative, non-government money market funds would be required to impose a 2 percent liquidity fee if the fund's level of weekly liquid assets fell below 15 percent of its total assets, unless the fund's board determined that it was not in the best interest of the fund. That determination would be subject to the board's fiduciary duty, and we believe it would be a high hurdle. After falling below the 15 percent weekly liquid assets threshold, the fund's board would also be able to temporarily suspend redemptions in the fund for up to 30 days - or "gate" the fund.

This "fees and gates" alternative potentially could enhance our regulation in several ways:

- First, it could more equitably allocate liquidity risk by assigning liquidity costs in times of stress (when liquidity is expensive) to redeeming shareholders - the ones who create the liquidity costs and disruption.
- Second, this alternative would provide new tools to allow funds to better manage redemptions in times of stress, and thereby potentially prevent harmful contagion effects on investors, other funds, and the broader markets. If the beginning of a run or significantly heightened redemptions occur, they would no longer continue unchecked, potentially spiraling into a crisis. The imposition of liquidity fees or gates would be an available tool to directly counteract a run.
- And, third, this approach also is targeted, focusing the potential limitations on a money market fund investor's experience to times of stress when unfettered liquidity can have real costs.

The two alternative approaches in today's proposal target the common goal of reducing the incentive to redeem in times of stress, albeit in different ways. Accordingly, the proposal requests comment on whether a better reform approach would be to combine the two alternatives into a single reform package - requiring that prime institutional funds have a floating NAV and be able to impose fees and gates in times of stress, and that retail funds be able to impose fees and gates. We specifically solicit and I am interested in commenters' views on this combined approach.

Greater Diversification, Disclosure and Reporting

Importantly, the staff's recommendations also contain a number of other significant reform proposals - tightening diversification requirements, enhancing disclosure requirements, strengthening stress testing and improving reporting on both money market funds and unregistered liquidity funds that could serve as alternatives to money market funds for some investors. These proposed reforms should further enhance the resiliency and transparency of this important product and are significant complements to the other proposals.

Today's proposal is the product of very hard work by all those who have sought to meaningfully reform this investment product that is such a critical piece of the nation's financial fabric.

There have been important and thoughtful comments throughout this process, including suggestions and recommendations from investors, the industry, and fellow regulators. We have given them all very careful consideration and they have proven invaluable to us formulating the important proposals we are voting on today.

In this regard I especially would like to thank all of my fellow Commissioners for their contributions and the spirit of cooperation in which we worked leading up to today's meeting.

I want to reiterate that our goal is to implement an effective reform that decreases the susceptibility of money market funds to run risk and prevents money market fund events similar to those that occurred in 2008 from repeating themselves. With this goal in mind, I very much look forward to the comments and am very pleased that, with my fellow Commissioners, we are moving this reform process forward.

Before I ask Norm Champ, Director of the Division of Investment Management, to discuss the proposed reforms, I would like to thank Norm and his team: Diane Blizzard, Sarah ten Siethoff, Thoreau Bartmann, Brian Johnson, Adam Bolter, Amanda Wagner, Kay Vobis, Jaime Eichen, and Megan Monroe for their tireless work on this rulemaking.

This rulemaking was a true team effort between the Division of Investment Management and the Division of Risk, Strategy and Financial Innovation, so I want to also express my gratitude for the work of Craig Lewis, Kathleen Hanley, Jennifer Marietta-Westberg, Woodrow Johnson, Jennifer Bethel, Virginia Meany, Dan Hiltgen, and Mila Sherman. I also would like to acknowledge the critical work and analysis included in the staff's economic study published late last year, which was highly influential in developing today's proposed reforms.

Thanks as well to Anne Small, Meridith Mitchell, Lori Price, Cathy Ahn, Jill Felker, and Kevin Christy from the Office of the General Counsel; Jim Burns, David Blass, Haime Workie, and Natasha Greiner from the Division of Trading and Markets; and Paul Beswick, Rachel Mincin, and Jeff Minton from the Office of the Chief Accountant.

And now I'll turn the meeting over to Norm Champ to provide a fuller explanation of the proposed reforms we are considering today.