Statement at SEC Open Meeting on Money Market Fund Reform

Chair Mary Jo White

Washington, D.C.

July 23, 2014

Good morning, everyone. This is an open meeting of the Securities and Exchange Commission on July 23, 2014.

The Commission will today consider three recommendations of the staff, all related to money market funds. We will discuss all of these items together and then will vote on each of the three action items separately following our discussion. The first is a recommendation to adopt final rules and the other two are proposals, and I look forward to the staff presentation on all three.

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Today's reforms will fundamentally change the way that most money market funds operate. They will reduce the risk of runs in money market funds and provide important new tools that will help further protect investors and the financial system in a crisis. Together, this strong reform package will make our financial system more resilient and enhance the transparency and fairness of these products for America's investors.

The Importance of Reform

Over the last several decades, money market funds have become a critical part of the American economy, providing an important source of short-term financing for issuers, including American businesses, state and local governments, and other market participants. Today, nearly $3 trillion is invested in money market funds, much of it in institutional prime funds held by investors such as pension funds and corporations. Issuers and investors now rely daily on money market funds, and the benefits of such funds are significant.

But the widespread use of money market funds can also create risks through investor runs and the contagion that can follow. During the last financial crisis, institutional prime money market funds experienced an unprecedented run when the Reserve Primary Fund "broke the buck" and declared it would no longer redeem investors' shares dollar-for-dollar. In one week, investors pulled approximately $300 billion from prime money market funds, or 14 percent of the assets in those funds. This phenomenon, together with other events in the fall of 2008, caused the short-term financing markets to dry up, severely limiting the ability of companies to borrow funds, manage cash, and continue fueling the American economy. As part of a program of extraordinary support across the financial system, a temporary guarantee program was provided through Treasury to stop the run on institutional prime funds, and the Federal Reserve established liquidity facilities.

The financial crisis was devastating, with severe and lasting losses for American households and the U.S. economy. In the years since, the Commission has advanced a full program of rulemaking and enforcement actions to promote financial system stability and protect American investors.

Part of that program has been putting to work the tools provided by the Dodd-Frank Act, which became law four years ago this week. The Commission has implemented new rules for private fund advisers, created a new regime for municipal advisors, finalized the Volcker Rule, and put in place new standards

for the clearing agencies that stand at the center of the financial system. We will soon be taking up final rules for credit rating agencies and asset-backed securities, as well as continuing to implement the Dodd-Frank requirements for over-the-counter derivatives and executive compensation.

Although money market fund reform is not directly mandated by the Dodd-Frank Act, it stands squarely within the vision of that statute, which in Title I called on the SEC and our fellow financial regulators to work together to identify and address systemic risks that could threaten the American economy.

The Road to Reform

The SEC has been the primary regulator of asset managers and funds for almost 75 years, and the reforms before us today carry forward this important responsibility. In 2010, the Commission adopted new requirements that demonstrably and significantly increased the resilience of money market funds. But as the Commission noted then, those measures were only a first step.

Since then, there has been no shortage of opinions and proposals to address the remaining risks associated with money market funds. The Commission has taken up and evaluated, among other measures, a floating NAV, capital buffers, minimum balances at risk, and fees and gates. As is known, the discussion within the Commission has been robust, as should be expected —indeed, welcomed — in an agency that is required to be independent and composed of five members of different backgrounds and perspectives.

And our discussions did not occur in a vacuum. The Commission was built on transparency and disclosure, and we embrace those principles. The Commission and its staff reviewed thousands of comment letters, met with hundreds of market participants, and directly engaged our fellow regulators on the full range of possible options. Our economists conducted extensive analyses of the available data, built and applied their own models, and shared their work with the public and other regulators.

Today's reforms are the culmination of this process. The proposal made last June was unanimously approved by the Commission, drawing on the experience and expert advice of a staff dedicated to this agency's mission to protect investors and our markets. But, as Congress anticipated in 1934 when it established the Commission, unanimity is not itself a goal. Choices must be made and differences will be expressed. That is entirely appropriate.

Strong and Enduring Reform

The recommendation before us today creates a very strong reform package that significantly mitigates the risks of a run in money markets funds and that will limit further contagion should a run occur.

The individual policy choices embodied in this recommendation have not been undertaken in isolation, but rather with a clear-eyed awareness of their assembly into a single coherent reform. Some elements of the recommendation have attracted more attention than others.

The first is the decision to recommend combining both of the principal reforms advanced in the proposal: a floating NAV for institutional prime funds and discretionary liquidity fees and gates for non-government funds. As any cursory glance at the comment file will reveal, this combination is not without debate.

But, proceeding with only one of these reforms would leave our work here today incomplete. The debate and analysis of the last several years have identified two distinct risks:

- One is the "first mover advantage" that incentivizes investors to be the first to redeem so that they receive the fixed price of their shares even if the market value of the fund's holdings is less per share. The floating NAV addresses this risk, as well as enhancing transparency and highlighting investment risk for shareholders.
- The second risk is widespread runs and the potential for contagion from one fund experiencing heavy shareholder redemptions. Fees and gates mitigate this risk and the potential impact for

investors and markets.

Bottom line: these reforms address risks in different ways and together provide protections greater than either would alone. This combination could diminish the attractiveness of institutional prime funds for some investors, and consequently reduce demand for some corporate issuances. But we cannot shrink from requiring a needed change in the marketplace. The goal is to strike a balance that preserves, where possible, the advantages that money market funds provide, while putting in place the measures necessary to better protect investors and promote market stability.

This balance is now possible because of key tax guidance that the Department of Treasury and the Internal Revenue Service have advised us they will release later today, which will eliminate significant costs of the floating NAV reform. They will propose new regulations to allow money market fund investors to use a simplified tax accounting method for determining gains and losses, which will eliminate the need to track individual purchase and sale transactions for tax reporting purposes. And, they will release a new revenue procedure that provides relief from the "wash sale" rules for any losses on shares of a floating NAV money market fund.

Another significant element of the recommendation is to require a floating NAV for institutional prime money market funds, but not for other money market funds. Some have argued that the floating NAV should be applied to all funds, regardless of their characteristics. But all money market funds are not alike, and neither is the balance of our key objectives. In particular, the balance between preserving the benefits of money market funds and addressing their potential risks must be closely evaluated in light of a fund's characteristics.

Institutional prime money market funds experienced the precipitous run during the financial crisis, and our analysis has shown that they continue to be the most susceptible to runs. Retail and government money market funds have not to date faced significant runs even in the worst of times; in fact, investors ran *to* government money market funds in 2008 and the value of their portfolios appreciated. At the same time, retail investors in particular have come to rely on the liquidity and stability of money market funds, and they lack investment substitutes with similar characteristics, including those that may be available to institutional investors.

Strong action does not mean blunt action, and — as the Commission has repeatedly said — reform must be tailored to preserve benefits like these for retail investors when the risks do not dictate otherwise. While the costs of a floating NAV can be justified against the demonstrable run risk in institutional prime funds, a different balance must be struck for retail and government funds.

A third element of the recommendation that has attracted significant attention is how we address the potential for "pre-emptive" runs sparked in the market by one fund implementing a fee or gate that raises questions for investors in other funds.

It is important to remember first and foremost how important fees and gates can be in a crisis situation. Quite simply, they are how a fund board can stop a potential run and prevent the spread of a disruption to the broader market in situations where a floating NAV alone will be ineffective. Fees more equitably allocate liquidity risk by making redeeming investors pay their share of the costs of the liquidity they receive in times of stress when liquidity is expensive. If a large number of redemptions do occur, gating will stop redemptions altogether for a period of time, ensuring they do not trigger fire sales of money market fund assets and risk spiraling into a crisis beyond the immediate fund.

While many strongly favor this reform, others have expressed a concern that it could do harm by potentially triggering destructive "pre-emptive" runs. This concern is important, but addressing it need not — and should not — mean foregoing an important reform. What we have done in response to this concern is to make significant modifications to the original proposal that, while preserving the fundamental utility of fees and gates, mitigate the pre-emptive run risk and dampen the effects if they were to occur.

- The recommendation, among other measures, increases the thresholds for imposing a fee or gate to a higher level of remaining liquid assets. A money market fund that imposes a fee or gate with substantial remaining internal liquidity is in a better position to bear those redemptions without a broader market impact because it can satisfy those redemption requests with cash, without selling assets, and this is less likely to generate a run in other funds.
- The recommendation makes the imposition of a fee or gate more discretionary, rather than the result of strict triggers. The absence of such triggers make it less likely that informed investors will be able to "front run" the exercise of a fee or gate, thereby precipitating a run.
- And the recommendation lessens the liquidity impact for investors of a fee or gate by, among other things, permitting only a short maximum gate. This change will also diminish the incentive of an investor to run in order to preserve liquidity.

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Beyond the principal reforms of a floating NAV and fees and gates, today's reform also establishes enhanced disclosure, diversification, and reporting requirements for money market funds. With this strong package of reforms, we have taken another significant step toward promoting financial stability and protecting the interests of investors.

It is a multi-faceted reform that warrants close monitoring as we proceed with implementation, and I have directed the staff to conduct an ongoing, comprehensive review of the impact of today's measures.

More broadly, looking ahead, market-based financing remains — quite appropriately — an area of intense focus after the financial crisis, and the SEC and our fellow regulators must ensure that our efforts work in tandem. The risks of short-term financing must continue to be identified and addressed, but so too must the benefits. And I am committed to strengthening the regulatory framework for these activities, whether conducted by bank or non-bank institutions.

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Before I ask Norm Champ, Director of the Division of Investment Management, to detail the proposed reforms, I would like to particularly thank Treasury and the IRS for their assistance in addressing the tax issues related to the floating NAV reform. I also would like to thank all of my fellow Commissioners — past and present — for their contributions to this rulemaking. I want to especially take note of the contributions of Commissioner Aguilar and Commissioner Gallagher, whose efforts and expertise over several years have ensured that we are proceeding with a full understanding of all the relevant policy and economic issues.

The Commission staff has applied its deep expertise of money market funds to this rulemaking and has worked tirelessly. And I would like to thank Norm and his team from the Division of Investment Management: Diane Blizzard, Sarah ten Siethoff, Penelope Saltzman, Thoreau Bartmann, Adam Bolter, Andrea Ottomanelli Magovern, Amanda Hollander Wagner, Erin Loomis, Kay-Mario Vobis, Sara Cortes, Doug Scheidt, Jaime Eichen, and Matt Giordano. From the Division of Trading and Markets, I would like to thank Stephen Luparello, Haimera Workie, Natasha Vij Greiner, Jonathan Shapiro, and George Makris.

SEC economists from DERA provided economic studies and analyses throughout this process that was essential in formulating the final reforms. I thank Jennifer Marietta-Westberg, Cristof Stahel, Jennifer Bethel, Daniel Hiltgen, Woodrow Johnson, and Anthony Kourtakis for their excellent work on these issues. And although he is no longer with the SEC, I would like to thank the former director of DERA, Craig Lewis, for all of the exceptional work and analysis he did while at the agency on money market fund reform.

Great thanks also to Annie Small, Meridith Mitchell, Michael Conley, Lori Price, Cathy Ahn, Brooks Shirey, Kevin Christy, Jill Felker, Mykaila DeLesDernier, and Jacob Loshin from the Office of the General Counsel; Paul Beswick, Rachel Mincin, and Blair Petrillo from the Office of the Chief Accountant; and Kathy Hsu, David Beaning, and Lulu Cheng from the Division of Corporation Finance.

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Related Materials

- Video of Chair White's Statement