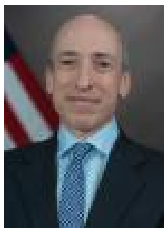
Statement before the Financial Stability Oversight Council on Money Market Funds, Open-End Bond Funds, and Hedge Funds



Chair Gary Gensler

Feb. 4, 2022

Thank you, Secretary Yellen, for focusing the Council's attention on financial resiliency with regard to three key parts of our capital markets — particularly money market funds, open-end bond funds, and hedge funds.

The fund industry gives retail and institutional investors the opportunity to pool their assets, get investment advice, and attain diversification and efficiency. These pools of assets have become a significant part of our markets. There's $5 trillion in money market funds, nearly $7 trillion in open-end bond funds, and $9 trillion in gross assets under management in hedge funds.

The nature, scale, and interconnectedness of these fund sectors, though, also pose issues for financial stability. This is not just based on financial economic theory, but also upon the practical lessons of the past. We've seen such risks emanate from these sectors during the 2008 financial crisis, at the start of the COVID crisis in March 2020, and in 1998, when the hedge fund Long-Term Capital Management failed.[1]

Money market funds and open-end bond funds, by their design, have a potential liquidity mismatch — between investors' ability to redeem daily on the one hand, and funds' securities that may have lower liquidity. While this might not be as significant a concern in normal markets, we've seen that in stress times, these funds' liquidity mismatches can raise systemic issues. Hedge funds can present financial resiliency risks through leverage or derivatives positions.

I think the Securities and Exchange Commission has a responsibility to help protect for financial stability, which maps onto many parts of our statutes, but particularly onto the "orderly" part of our mission. Thus, I've asked SEC staff to make recommendations for the Commission's consideration with regard to bolstering the resiliency of each of these fund sectors.

The Commission recently voted to propose amendments to rules that govern money market funds. I'd like to thank William Birdthistle and Sarah ten Siethoff for their work and today's presentation on the SEC's proposal.

With respect to open-end bond funds, I've asked staff whether there are improvements we can consider regarding the fund liquidity rule or through other reforms to enhance fund liquidity, pricing, and resiliency in possible future stress events.

With respect to hedge funds, in January, the Commission voted to propose amendments to Form PF — a form first adopted after the financial crisis that provides certain private fund information to the SEC and other financial regulators. Among other things, the proposed amendments would require certain advisers to hedge funds to provide current reporting of events that could be relevant to financial stability. Looking ahead, I've asked staff to work jointly with staff at the Commodity Futures Trading Commission to consider whether they would recommend amending the joint portions of Form PF related to the periodic reports of hedge funds.

Further, in November, the Commission proposed a rule to require public reporting of large security-based swap positions. Total return swaps, a type of security-based swaps, contributed to the transmission of risk during the failure of Archegos Capital Management last year. We also re-proposed a new rule to prevent fraud, manipulation, and deception in connection with security-based swap transactions.

I support the FSOC Statement on Nonbank Financial Intermediation today and welcome FSOC members' input on the SEC's ongoing consideration on how to best enhance resiliency in these critical fund sectors.

Thank you.

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[1] *See* Bauer College of Business, University of Houston, "Case Study: LTCM" (spring 2006), *available at* : https://www.bauer.uh.edu/rsusmel/7386/ltcm-2.htm.