

## Temporary Liquidity Gates, Fees Concept Only Viable FSOC Option for Prime Money Market Funds

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## ICI Comment Letter to FSOC Opposes Flawed Proposals; Raises Concerns About Council's Legal Authority and Analysis

**Washington, DC, January 24, 2013** - Temporary "gates" to halt redemptions from prime money market funds during times of market stress, with the option to impose fees for further asset withdrawals, could address regulators' concerns about redemption pressures, the Investment Company Institute says.

In addition to detailing its temporary gate and fee concept in a [comment letter](#) filed with the Financial Stability Oversight Council (FSOC), ICI also explains the fund industry trade association's continued opposition to FSOC's three flawed regulatory proposals; explains that FSOC has not made the case for applying any reforms to government, Treasury or tax-exempt funds; highlights FSOC's failure to follow the legal process required by the Dodd-Frank Act; analyzes the misleading and incorrect statements FSOC uses as a foundation for its case for making fundamental changes to money market funds; and points out FSOC's required economic analysis has significant shortcomings.

"As we have for more than four years, ICI continues to pursue proposals that can increase the resilience of money market funds without changing the fundamental nature and value of these funds," said ICI President and CEO Paul Schott Stevens. "A temporary gate with the option for a fee is the only proposal under discussion that would stop redemptions during extreme market stress. The other recycled regulatory proposals FSOC suggests would not accomplish regulators' stated goals and, in fact, would be counter-productive in light of the harm they would inflict on investors and the economy."

## Temporary Gates, Fees and Enhanced Disclosure Only Viable FSOC Regulatory Option

In its comment letter, ICI details how [temporary restrictions on redemptions, or "gates" and fees, combined with enhanced disclosure](#), would act as a "circuit breaker" on heavy redemptions from prime funds during times of market stress. Unlike the other FSOC proposals, the ICI proposal would not limit investors' access to their shares during normal market conditions, and thus would not change the fundamental characteristics of money market funds or their value to investors and the economy.

- Temporary restrictions on redemption, or "gates," if triggered on liquidity levels, would prohibit investors from redeeming and would provide time for the fund to restore liquidity.
- Temporary liquidity fees, if determined appropriate by a fund's board, would allow redeeming shareholders access to liquidity if they need it, but would impose a fee to compensate the fund and remaining investors for the potential cost to the fund of the withdrawal and to protect remaining shareholders.
- Enhanced disclosure of mark-to-market NAVs and portfolio liquidity levels would give regulators and investors more insight into portfolio holdings.

## ICI Continues to Oppose Proposals That Will Harm Investors and the Economy

ICI continues to oppose all three of the alternative money market fund recommendations proposed by FSOC: forcing funds to buy and sell shares at a "floating" net asset value (NAV) and an initial share price of \$100.00, a NAV buffer and "minimum balance at risk," and a significantly larger NAV buffer combined with "other measures." All of these concepts have faced strong public opposition in earlier forms, as evidenced in the [SEC's comment letter file](#) for money market funds.

- A [floating NAV](#) would harm investors and the economy. It would not change shareholder behavior and would deprive state and

local governments of much-needed financing. FSOC's floating NAV proposal introduces a host of tax, accounting and operational complications that will drive many investors to less transparent and less regulated alternatives. Additionally, FSOC's concept of requiring money market funds to offer shares at a \$100.00 NAV is without precedent—no other mutual fund faces such a requirement—and would seem to require money market funds to comply with a pricing standard that is at least 10 times more onerous than the standard articulated by Securities and Exchange Commission accounting guidance. Sponsors would be unlikely to offer such funds, and investors would be unlikely to buy them.

- [The proposal for a minimum balance at risk \(MBR\)](#), coupled with 1 percent capital (or NAV buffer), is deeply flawed. The MBR would withhold 3 percent of an investor's redemptions for 30 days and place those withheld amounts in a first-loss position if the fund suffers losses in excess of the 1 percent NAV buffer. The most likely impact of the MBR would be to drive investors as well as intermediaries away from money market funds. ICI strongly opposes denying investors access to their assets when liquidity is available in a money market fund, a change that would impair a fundamental protection that mutual fund investors have enjoyed for more than 70 years. The MBR represents an experiment on the \$2.3 prime, government and tax-exempt money market fund industry that could have harmful consequences for the broader markets and economy. Further, FSOC provides no evidence or analysis to show that the MBR concept would achieve its goal of discouraging shareholders from redeeming in times of market stress.
- [The proposal for a NAV buffer of up to 3 percent of fund assets](#) would likely drive money market fund sponsors out of business, depriving investors, issuers and the economy of the benefits of money market funds. Requiring advisers to commit capital would likely drive sponsors away from offering regulated money market funds; requiring funds to raise capital in the market is unworkable; and requiring funds to accumulate a within-fund capital buffer from retained earnings would take 10 to 15 years in the current near-zero yield environment. NAV buffers at smaller amounts would still present hardships, and would accomplish little.

## **FSOC Has Not Made the Case That Any of Its Proposals Should Apply to Treasury, Government, Tax-Exempt Money Market Funds**

ICI continues to believe that the reform measures being proposed by FSOC are inappropriate for all money market funds. In particular, [FSOC has not explained or shown why any additional regulations are necessary for Treasury, government and tax-exempt funds](#), given their distinct risk profiles and redemption experience. If, however, FSOC can demonstrate that changes are needed for prime money market funds, ICI would support a recommendation to the SEC that it implement temporary gates and fees for prime money market funds (as outlined above).

## **FSOC Acting Outside Legal Authority**

The current FSOC action on money market funds represents FSOC's first and only use of its authority under Section 120 of the Dodd Frank Act. Its action therefore requires careful evaluation to ensure it meets the standards and requirements set by Congress.

ICI notes that Congress requires FSOC to follow numerous statutory requirements in making a recommendation to a financial regulatory agency on enhanced regulation under Section 120 of the Dodd Frank Act. Legal analysis shows that FSOC has failed to meet the necessary requirements, acting outside its legal authority.

"In taking action on money market funds at this time, FSOC has overstepped its legal authority as defined by Congress," said ICI General Counsel Karrie McMillan. "It is proceeding before necessary rules are finalized and in place. The fact that FSOC is acting with such haste and without adequate concern for the process outlined in the Dodd-Frank Act is very troubling."

ICI is requesting that FSOC withdraw the proposed recommendations until the appropriate process has been followed and a determination has been made that money market funds meet the necessary requirements.

## **FSOC's Recommendations Based on Inaccurate Assertions and Lacking Analysis**

ICI strongly objects to FSOC taking the drastic step of using its [Section 120 authority premised on faulty assumptions and inaccurate data analysis](#). These misstatements and omissions are not merely incidental mistakes—they are the foundation of FSOC's case for fundamental changes to money market funds.

FSOC's basis for determining that "the conduct, scope, nature, size, scale, concentration, or interconnectedness" of money market funds pose systemic risks relies upon assertions that distort the record of the financial crisis of 2007–2008, exaggerate the role of money market funds in that crisis, and ignore the substantial impact of the 2010 SEC reforms. FSOC's determination also is based on the faulty premise that the features it ascribes to money market funds are unique, and that risks it ascribes to money market funds are not attributable to the functioning of cash-management products or the short-term markets generally.

ICI comments demonstrate, with substantial empirical data, that these premises are incorrect, and point out that focusing attention on one product will not address broader systemic concerns in the short-term markets.

## **ICI Finds FSOC's Economic Analysis Has Significant Shortcomings**

Under Section 120 of the Dodd-Frank Act, FSOC must “take costs to long-term economic growth into account” when recommending new or heightened standards and safeguards for a financial activity. FSOC’s economic analysis exaggerates potential benefits of its proposed reforms. For example, the FSOC report fails to demonstrate that the reforms it advocates would meet its stated goals of strengthening the financial system and it ignores the effects of the SEC’s 2010 amendments to money market fund regulations. Furthermore, the report fails to consider the costs to the economy should their proposals drive investors to less regulated products and increase risks in the financial system.

The lack of analysis in the Report demonstrates that [FSOC did not adequately fulfill its legal obligation under the Dodd-Frank Act to assess the costs of its proposals on long-term economic growth.](#)

For more information about money market funds, please visit our [money market fund resource center.](#)

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