Client Alert.

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SEC Statement on Money Market Fund Reforms

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On August 22, 2012, SEC Chairman Mary Schapiro announced that three of the five SEC Commissioners, constituting a majority of the Commission, had informed her that they would not support a staff proposal to reform money market funds. As a result, the Chairman canceled the Commission's consideration of controversial money market fund reforms.

The proposal would have been the second phase of the Chairman's oft-stated plan that she said would reduce money market funds' susceptibility to runs, protect retail investors, and lessen the potential need for future bailouts. In her statement, Chairman Schapiro urged other policymakers to consider ways to address what she perceives to be systemic risks posed by money market funds.

Chairman Schapiro sought to tighten credit quality, liquidity and maturity rules after the Reserve Primary Fund "broke the buck" in 2008 as a result of its large holdings of Lehman Brothers commercial paper. In 2010, the SEC adopted rules that shortened maturities, improved credit qualities, and imposed liquidity and new disclosure requirements on money market funds. The SEC said that the revised rules were "designed to significantly strengthen the regulatory requirements governing money market funds and better protect investors." When announcing the 2010 rule changes, however, Chairman Schapiro noted they were "an important first step in [the SEC's] efforts to strengthen the money market regime." Since that time Chairman Schapiro and other regulators, legislators, and industry participants have actively engaged in a lively public debate regarding the need for additional structural money market reforms.

The controversial rule proposals reportedly would have required money market funds to choose between two alternative structures. The first would have called for money markets funds to float their NAV and use mark-to-market valuation like other mutual funds. The second would have required funds to adopt a capital buffer of less than 1% of fund assets to absorb the day-to-day variations in the value of a money market fund's holdings. This latter proposal would be combined with a minimum balance at risk requirement that would restrict shareholders from redeeming their full account value at one time by imposing a 3% holdback.

As Chairman Schapiro pointed out, the Commission has actively engaged with the industry, investors, academics and other regulators, including the ICI Money Market Fund Working Group, the President's Working Group (the precursor to the Financial Stability Oversight Council (FSOC) established under the Dodd-Frank Wall Street Reform and Consumer Protection Act), and representatives of the U.S. Treasury and the Federal Reserve Board, about the need for additional structural reforms. It now appears, however, that the SEC Commissioners cannot agree on a regulatory approach.

On August 23, 2012, Commissioner Luis Aguilar issued a statement that urges the Commission to consider a concept release to probe the cash management industry as a whole, rather than focusing on money market funds in isolation. Other policymakers may step into the fray and continue the debate. For example, some have speculated that the FSOC could assert control over certain large money market funds by designating them "systemically important financial institutions." So while there is an opportunity for the money market fund industry to catch its breath, it is unlikely that we have heard the last about money market reforms.

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