MEMO# 30544

January 27, 2017

ICI Files Comment Letter on Federal Reserve Bank of Minneapolis Proposed "Shadow Bank" Tax on Regulated Funds

[30544] January 27, 2017 TO: ICI Members SUBJECTS: Money Market Funds Systemic Risk RE: ICI Files Comment Letter on Federal Reserve Bank of Minneapolis Proposed "Shadow Bank" Tax on Regulated Funds

In mid-November, the Federal Reserve Bank of Minneapolis issued for public comment a paper entitled “The Minneapolis Plan to End Too Big to Fail” (“Plan”).[1] The Plan proposes a new approach to minimize the risk of failure for very large banks and associated spillover effects to financial markets, the overall economy and American taxpayers. It includes a proposed “leverage tax” on “shadow banks,” including mutual funds and money market funds (“regulated funds”). The Plan is not a formal regulatory proposal and stands little chance of becoming law. Nevertheless, ICI recently filed a comment letter with the Federal Reserve Bank of Minneapolis in an effort to dispel mischaracterizations of regulated funds that could influence future policy initiatives. A copy of our comment letter is attached and brief descriptions of the Plan and our comment letter follow below.

The Plan

The Plan calls for high capital requirements—23.5% of risk-weighted assets—on the largest bank holding companies, those with assets of at least $250 billion (“covered banks”). Such requirements, according to the Plan, would incentivize a covered bank to restructure to an extent that the US Treasury Secretary would certify that the covered bank is no longer systemically important. Covered banks not receiving such certification would be subject to a further “systemic risk charge,” designed to bring their total capital up to a maximum of 38% over time.

The Plan also seeks to “prevent future [too big to fail] problems in the shadow financial sector” on the assumption that higher capital requirements for covered banks will encourage the movement of “banking activity” to “less-regulated firms that are not subject to such stringent capital requirements.” It proposes to reduce the incentive for such movement, and to “equalize funding costs,” by applying a “leverage tax” to “shadow banks” with assets of at least $50 billion. All so-called shadow banks would pay a 2.2% tax on their borrowings, unless the Treasury Secretary certifies that a particular institution does not pose systemic risk (in which case the institution would pay a lower tax rate of 1.2%). The Plan characterizes a widely diverse group of nonbank financial institutions—including mutual funds and money market funds—as lightly regulated or unregulated “shadow banks.”

ICI's Comment Letter

In our comment letter, we focused on the Plan's proposed tax on certain mutual funds and money market funds. We explained why such a tax would be wholly inappropriate and would not advance the Plan's policy goals.[2]

First, we explained that mutual funds and money market funds do not present "too big to fail" concerns. These highly transparent, comprehensively regulated funds do not engage in "banking activity," nor do they "fail" as banks do. We also discussed why taxing the largest mutual funds and money market funds, as the Plan envisions, would not bring greater stability to the financial system but instead would only serve to harm American taxpayers who invest in regulated funds. Our letter stated that, for all of these reasons, any proposed "shadow bank" tax should not apply to regulated funds. In addition, we strongly recommended that the Minneapolis Fed make all comments on the Plan publicly available in their entirety, rather than merely providing a summary of the comments received.

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Associate General Counsel & Corporate Secretary

Attachment

endnotes

[1] Federal Reserve Bank of Minneapolis, *The Minneapolis Plan to End Too Big to Fail (Nov. 16, 2016), available at* https://www.minneapolisfed.org/~/media/files/publications/studies/endingtbtf/the-minneapolis-plan/the-minneapolis-plan-to-end-too-big-to-fail-2016.pdf?la=en.

[2] Our letter did not offer an opinion on the merits of the Plan or its implications for banks or for nonbank financial institutions other than regulated funds.