MEMO# 23315

March 12, 2009

ICI Testimony Before Senate Banking Committee On Financial Services Regulatory Reform, Money Market Funds

[23315]

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UNIT INVESTMENT TRUST MEMBERS No. 3-09 RE: ICI TESTIMONY BEFORE SENATE BANKING COMMITTEE ON FINANCIAL SERVICES REGULATORY REFORM, MONEY MARKET FUNDS

On March 10, ICI President and CEO Paul Schott Stevens testified before the Senate Banking Committee at a hearing entitled “Investor Protection and the Regulation of Securities Markets.” His written testimony is attached and summarized below.

ICI Recommendations on Financial Services Regulatory Reform

In his testimony, Stevens outlined ICI's recommendations on how to reform the U.S. financial regulatory system, as detailed in its recently released white paper, Financial Services Regulatory Reform: Discussion and Recommendations. [1] Those recommendations include: (1) designating an agency or inter-agency body to serve as a Systemic Risk Regulator; (2) creating a Capital Markets Regulator representing the combined functions of the Securities and Exchange Commission and the Commodity Futures Trading Commission; (3) considering consolidation of the bank regulatory structure and authorization of an optional federal charter for insurance companies; and (4) enhancing coordination and information sharing among federal financial regulators. The testimony noted that, if enacted, these reforms would improve regulators' capability to monitor and mitigate risks across the financial system, enhance regulatory efficiency, limit duplication, close regulatory gaps, and emphasize the national character of the financial services industry, and increase protections for consumers and investors.

Stevens indicated that the Systemic Risk Regulator should have responsibility for: (1) monitoring the financial markets broadly; (2) analyzing changing conditions in domestic and overseas markets; (3) evaluating the risks of practices as they evolve and identifying those that are of such nature and extent that they implicate the health of the financial system at large; and (4) acting in coordination with other responsible regulators to mitigate such risks. The testimony emphasized that careful consideration should be given to how the Systemic Risk Regulator will be authorized to perform its functions and its relationship with other, specialized regulators.

Stevens testified that the Capital Markets Regulator should have oversight responsibility for the capital markets, market participants, and all financial investment products. He said that it should be the regulatory standard setter for investment companies, including money market funds. Stevens' testimony recommended that the agency's mission focus on investor protection and law enforcement, as well as maintaining the integrity of the capital markets. In addition, the testimony suggested that the Capital Markets Regulator, like the SEC, should be required to consider whether proposed regulations both protect investors and promote efficiency, competition, and capital formation. It stated that the Capital Markets Regulator should be an independent agency, with the resources to fulfill its mission and the ability to attract experienced personnel who can fully grasp the complexities of today's markets. The testimony noted that ICI's white paper offers recommendations for organizing and managing the new agency and for how the agency can maximize its effectiveness.

The testimony recommended that the Capital Markets Regulator be given express authority to regulate in areas where there are currently gaps that have the potential to impact the capital markets and market participants, and to modernize regulation that has not kept pace with changes in the marketplace. These areas include: (1) hedge funds; (2) derivatives; (3) municipal securities; and (4) the regulation of investment advisers and broker-dealers.

Recent Market Events and Money Market Funds

Stevens then addressed recent market events and money market funds. By way of background, he testified that money market funds are one of the most notable product innovations in American history. These funds—which seek to offer investors stability of principal, liquidity, and a market-based rate of return, all at a reasonable cost—serve as an effective cash management tool for retail and institutional investors, and are an exceptionally important source of short-term financing in the U.S. economy.

The testimony stated that until September 2008, money market funds (in some cases with support from their sponsors) largely weathered severe pressures in the fixed income markets that had been striking banks and other financial services firms since 2007. In mid-September, a series of extraordinary developments, including the failure of Lehman Brothers, roiled financial markets around the globe, affecting all market participants. In the midst of this market storm, one money market fund holding a substantial amount of Lehman commercial paper was unable to sustain a net asset value of $1.00 per share. The testimony explained that the news of this fund "breaking the buck," combined with broader concerns about the building stresses in the money market and possible failures of other financial institutions, led to heavy redemptions in prime money market funds as investors sought safety and liquidity in Treasury securities.

Stevens said that unprecedented government initiatives—designed to provide stability and liquidity to the markets and to support money market funds—successfully bolstered investor confidence. He pointed out that to date, the Treasury Temporary Guarantee Program for Money Market Funds has received no claims for its guarantee, and he added that none are anticipated. The testimony indicated that, assuming continued progress in restoring the health of the money market, there will be no need to extend the Temporary Guarantee Program beyond its current one-year maximum period.

The testimony described the fund industry's efforts to capture the lessons learned from recent experience, noting that in November, ICI formed a Money Market Working Group of senior fund industry leaders, led by John J. Brennan of The Vanguard Group. The Working Group has conducted a thorough examination of how the money market can function better, and how all funds operating in that market, including registered money market funds, should be regulated. The testimony announced that the Working Group intends to report its findings, conclusions, and recommendations later this month. It expressed ICI's belief that prompt implementation of the Working Group's recommendations will help assure a smooth transition away from the Temporary Guarantee Program.

Also testifying at the hearing were: Mercer Bullard, Associate Professor, University of Mississippi School of Law and President, Fund Democracy; John Coffee, Adolf A. Berle Professor of Law, Columbia University; Thomas G. Doe, CEO, Municipal Market Advisors; Robert Pickel, Executive Director and CEO, International Swaps and Derivatives Association; Timothy Ryan, President and CEO, Securities Industry and Financial Markets Association;

Damon Silvers, Associate General Counsel, AFL-CIO; and Lynn E. Turner, Former Chief Accountant, U.S. Securities and Exchange Commission. [2]

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Attachment

endnotes

[1] The white paper is available at http://www.ici.org/pdf/ppr_09_reg_reform.pdf.

[2] Copies of the witnesses' statements and the opening statement of Committee Chairman Christopher Dodd (D-CT) are available at: http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=faf91bea-ca58-4bc1-873d-33739dbb4f76.