MEMO# 22890

September 19, 2008

Treasury and Federal Reserve Announce Comprehensive Program Relating to Market Developments; SEC Issues Orders To Address Market Developments

[22890]

September 19, 2008

TO: BOARD OF GOVERNORS No. 8-08
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 21-08
INVESTMENT COMPANY DIRECTORS No. 16-08
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 25-08
PRIMARY CONTACTS - MEMBER COMPLEX No. 7-08
PRIMARY CONTACTS - MONEY MARKET FUNDS No. 1-08
SEC RULES MEMBERS No. 92-08 RE: TREASURY AND FEDERAL RESERVE ANNOUNCE COMPREHENSIVE PROGRAM RELATING TO MARKET DEVELOPMENTS; SEC ISSUES ORDERS TO ADDRESS MARKET DEVELOPMENTS

This morning Treasury Secretary Henry M. Paulson Jr. and Federal Reserve Chairman Ben Bernanke announced measures intended to stabilize the U.S. financial markets. The measures include the establishment of a temporary guaranty program for certain money market mutual funds [1] and initiatives intended to provide liquidity in the asset-backed commercial paper ("ABCP") and agency securities markets and in turn assist money market funds in meeting redemptions. [2] Separately, the Securities and Exchange Commission issued two emergency orders implementing coordinated actions to address concerns with short selling and an emergency order easing restrictions on the ability of securities issuers to repurchase their securities. We discuss each of these developments in turn below.

Guaranty Program for Money Market Funds

The Treasury Department announced the establishment of a one-year guaranty program for the money market fund industry that would insure the holdings of any publicly offered eligible Rule 2a?7 money market mutual fund – both retail and institutional – that pays a fee to participate in the program.

Based on currently available information, the program would make the assets of the Exchange Stabilization Fund [3] (a total of up to $50 billion) available to guarantee the payment to investors of money market funds with a net asset value that falls below $1. Specifically, the program would be triggered once a fund's board of directors acts to liquidate the fund and it is determined that shareholders would, absent the program, receive less than $1.

These are the details as we understand them:

- The program is temporary (one year).
- The program is voluntary on a fund-by-fund basis.
- According to the press release, the program is limited to certain publicly offered Rule 2a-7 funds. We were told last night by Treasury that only non-government, non-agency Rule 2a-7 funds could participate.
- Funds would pay a nominal fee to the Treasury (we have not heard more details on this amount).
- Insurance would not be capped (e.g., not like FDIC $100,000 per account limits).
- The Treasury would not regulate money market funds.
- Once a board determines a fund has broken a buck and decides to liquidate (a "trigger event"), the fund could liquidate in an orderly manner and any shortfall would be covered by the Treasury.

The SEC, which has been tasked to develop the program, has reached out to the Institute and its members to help it and the Treasury flush out the details of the program.

Federal Reserve Lending Program

The Federal Reserve announced this morning that it is putting in place a new lending program intended to foster liquidity in the asset-backed commercial paper market and to assist money market funds in meeting redemptions. The program will extend non-recourse loans at the primary credit rate to U.S. depository institutions and bank holding companies to finance their purchases of high-quality (A1/P1) ABCP from Rule 2a-7 money market funds.

Funds that are interested in participating in the program should work through clearing or custodial banks, which will in turn work through their local Federal Reserve Bank. Although details of the program are still being worked out, it is expected to begin functioning "immediately" and will be administered through the Federal Reserve Bank of Boston.

The Federal Reserve's press release makes no mention of municipal securities, which would thus appear to be ineligible for discounting. Non-asset backed commercial paper also appears to be ineligible for this new program.

Federal Reserve Purchases of Agency Debt

The Federal Reserve also announced today that it will begin purchasing short-term debt obligations issued by Fannie Mae, Freddie Mac, and Federal Home Loan Banks. The goal of this program is to bring back liquidity into the agency market by reducing primary dealers' holdings of these securities.

SEC Orders Addressing Market Developments

Temporary Ban on Short Sales

This order temporarily bans short selling in the securities of 799 financial firms [4] to prevent short selling from being used to drive down the share prices of issuers even where there is no fundamental basis for a price decline other than general market conditions. The order includes several exemptions to the short sale ban, including for certain bona fide market makers. The order is effective immediately and will terminate at 11:59 p.m. Eastern time on October 2, 2008, unless the SEC determines to extend it for up to a total of 30 calendar days.

Temporary Short Sale Reporting Requirement

This order will temporarily require that institutional money managers report information about daily short sales of securities. [5] The rule will require an "institutional investment manager" who has filed or was required to file a Form 13F for the calendar quarter ended June 30, 2008 to file a report with the SEC on new Form SH on the first business day of every calendar week immediately following a week in which it effected short sales.

The Form SH must be filed electronically and will be publicly available on EDGAR. The information required will include the number and value of securities sold short for each Section 13(f) of the Securities Exchange Act of 1934 security, the opening short position, the closing short position, the largest intraday short position, and the time of the largest intraday short position, for that security during each calendar day of the prior week. The order includes a de minimis exemption. Specifically, a manager does not have to report short positions if the short position constitutes less than one-quarter of one percent of the class of the issuer's Section 13(f) securities issued and outstanding and the fair market value of the short position is less than $1,000,000. The order becomes effective on September 22, 2008 and the first Form SH will be required to be filed on September 29, 2008. The order will terminate at 11:59 p.m. on October 2, 2008 unless extended by the SEC.

Issuer Repurchases

This order temporarily alters the timing and volume restrictions of Rule 10b-18 under the Exchange Act to provide issuers with greater flexibility to buy back their securities. [6]

Specifically, the order suspends the time of purchases conditions as specified in Rule 10b-18 and modifies the volume of purchases condition so that the amount of Rule 10b-18 purchases must not exceed 100 percent of the average daily trading volume for the security.

We will continue to update you on developments as we learn of them.

Paul Schott Stevens
President & CEO

endnotes

[1] See Treasury Announces Guaranty Program for Money Market Funds, press release dated September 19, 2008, available on the Treasury's website at http://treasury.gov/press/releases/hp1147.htm.

[2] See Board of Governors of the Federal Reserve System, press release dated September 19, 2008, available on the Federal Reserve's website at http://federalreserve.gov/newsevents/press/monetary/20080919a.htm.

[3] The Exchange Stabilization Fund was established by the Gold Reserve Act of 1934 to authorize the Secretary of the Treasury, with the approval of the President "to deal in gold, foreign exchange, and other instruments of credit and securities" to promote international financial stability.

[4] See Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, SEC Release No. 34-58592 (September 18, 2008), which may be found at: http://www.sec.gov/rules/other/2008/34-58592.pdf. The list of 799 securities is attached as

an appendix to the order.

[5] See Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, SEC Release No. 34-58591 (September 18, 2008), which may be found at: http://www.sec.gov/rules/other/2008/34-58591.pdf.

[6] See Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments, SEC Release No. 34-58588 (September 18, 2008), which may be found at: http://www.sec.gov/rules/other/2008/34-58588.pdf.