

MEMO# 26691

November 16, 2012

FSOC Proposes Money Market Fund Reforms

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TO:

ACCOUNTING/TREASURERS COMMITTEE No. 17-12
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 55-12
BROKER/DEALER ADVISORY COMMITTEE No. 61-12
INDEPENDENT DIRECTORS COUNCIL No. 1-12
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 55-12
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 48-12
OPERATIONS COMMITTEE No. 48-12
SEC RULES COMMITTEE No. 73-12
SMALL FUNDS COMMITTEE No. 30-12
TRANSFER AGENT ADVISORY COMMITTEE No. 71-12

RE:

FSOC PROPOSES MONEY MARKET FUND REFORMS

The Financial Stability Oversight Council has voted to propose recommendations for money market fund reform. [*] The proposed recommendations were issued under Section 120 of the Dodd-Frank Act, which authorizes FSOC to determine that a financial activity or practice could create or increase the risk of significant liquidity, credit, or other problems and to issue recommendations for more stringent regulation to the primary financial regulatory agency; which in this case would be the SEC. FSOC proposes to determine that money market funds' activities and practices could create or increase these risks and to recommend three alternative reforms to money market funds. These reforms could be adopted in the alternative, in which case a money market fund could choose which reform applied to it. FSOC also requests comments on other possible reforms, including liquidity fees and gates.

Alternative One: Floating Net Asset Value

This reform would require money market funds to have a floating net asset value (“NAV”) per share by removing the ability of these funds to utilize amortized cost accounting and/or penny rounding to maintain a stable NAV. Under this proposal, each money market fund would re-price its shares to \$100.00 and would reflect the actual market value of the underlying portfolio holdings, consistent with the requirements that apply to all other mutual funds (e.g., amortized cost generally could still be used if the security has a remaining maturity of 60 days or less). This reform would seem to apply to all types of money market funds, although existing money market funds could be grandfathered and allowed to maintain a stable NAV for a phase-out period.

This reform also would involve the rescission of Rule 22e-3, which allows a money market fund to suspend redemptions and begin an orderly liquidation if the fund has broken or is about to break the dollar, and Rule 17a-9, which allows affiliates of a money market fund to purchase portfolio securities from the fund in order to support the fund’s stable NAV./p>

Alternative Two: Stable NAV with NAV Buffer and “Minimum Balance at Risk”

This reform would require money market funds (other than Treasury funds) to maintain (i) an NAV buffer of up to 1.00 percent of the fund’s assets to absorb day-to-day fluctuations in the value of the funds’ portfolio securities and allow the funds to maintain a stable NAV, and (ii) apply a minimum balance at risk (“MBR”) requirement to shareholders. The NAV buffer would be calculated as follows: no buffer requirement for cash, Treasury securities, and Treasury repos; a 0.75 percent buffer requirement for other daily liquid assets (or for weekly liquid assets, in the case of tax-exempt funds); and a 1.00 percent buffer requirement for all other assets. A money market fund would be permitted to use any funding method or combination of methods to build the NAV buffer and would have one year to put in place a buffer equal to one-half of the required buffer size and two years to put in place the full required buffer.

The NAV buffer would be paired with a requirement that 3 percent of a shareholder’s highest account value in excess of \$100,000 during the previous 30 days—a MBR—be made available for redemption on a 30-day delay. The MBR requirement would apply to each record holder, including financial intermediaries, unless the intermediaries provide the fund sufficient information to apply the requirement to the intermediaries’ individual customers directly. For example, if an investor with an MBR chose to redeem all its shares, the fund would be required to delay redemption of the MBR for 30 days, during which time the MBR would be subject to first loss (subordinated) to other investors. In addition, a portion of an investor’s MBR could be subordinated if the investor had made net redemptions in excess of \$100,000 during the prior 30 days, with the extent of subordination approximately proportionate to the shareholder’s cumulative net redemptions during the prior 30 days.

In the event that a money market fund suffers losses that exceed its NAV buffer, the losses would be borne first by the MBRs of shareholders who have recently redeemed.

Alternative Three: Stable NAV with NAV Buffer and Other Measures

This reform requires money market funds (except Treasury funds) to have a risk-based NAV buffer of up to 3.00 percent to provide explicit loss-absorption capacity that could be combined with other measures. The NAV buffer could be raised through various methods. There would be no buffer requirement for cash, Treasury securities, and Treasury repos; a 2.25 percent buffer requirement for other daily liquid assets (or for weekly liquid assets, in

the case of tax-exempt funds); and a 3.00 percent buffer requirement for all other assets. This alternative contemplates a multi-year transition period, but a money market fund would have one year to put in place a buffer equal to one-sixth of the buffer size and two years to put in place one-third of the required NAV buffer.

This alternative also contemplates several additional measures (which the FSOC could determine would reduce the size of the NAV buffer required in a final recommendation), including more stringent investment diversification requirements, increased minimum liquidity levels (e.g., 20 percent daily and 40 percent weekly), and more robust disclosure requirements.

Comments are due 60 days after publication in the Federal Register. FSOC will then consider the comments and may issue a final recommendation to the SEC. The SEC then is required by the Dodd-Frank Act to impose the recommended standards (e.g., through a rulemaking subject to public comment), or similar standards that FSOC deems acceptable, or explain in writing to FSOC within 90 days why it has determined not to follow the recommendation.

Jane G. Heinrichs
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endnotes

[*] The FSOC press release, with a link to the proposed recommendations, is available at <http://www.treasury.gov/press-center/press-releases/Pages/tg1764.aspx>.

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