MEMO# 26092

April 30, 2012

IOSCO Requests Comments on Money Market Fund Reform Options

[26092]

April 30, 2012

TO: INTERNATIONAL MEMBERS No. 14-12
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 28-12
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 16-12
SEC RULES MEMBERS No. 32-12 RE: IOSCO REQUESTS COMMENTS ON MONEY MARKET FUND REFORM OPTIONS

The Technical Committee of the International Organization of Securities Commissions ("IOSCO") has issued a consultation report sharing its views and seeking comments on the possible risks money market funds pose to systemic stability and on possible policy options to address these risks. [*] Comments are due by Monday (Memorial Day), May 28, 2012.

IOSCO's report is a review, at the request of the Financial Stability Board ("FSB"), of potential regulatory reforms for money market funds, taking into account national regulatory initiatives. As part of this review, the FSB asked IOSCO to develop policy recommendations by July 2012. In turn, IOSCO mandated its Standing Committee on Investment Management to undertake the review and put forth recommendations for consideration. The Securities and Exchange Commission is a member of both IOSCO and the FSB.

The report first provides an overview of the systemic importance of money market funds, including their importance to issuers and investors. The report notes that although important reforms have already been adopted and implemented to address some of the shortcomings identified during the 2007-2008 financial crisis, several areas of risk remain, including their vulnerability to runs, particularly in case of a credit event. It also notes that their importance and interconnectedness with the rest of the financial system make money market funds' safety paramount for financial stability at large. The report cautions, however, that any policy options will have to be carefully weighed in the context of their potential impact on financial stability and market functioning, including the impact on competition and diversity, moral hazard, impact on the short-term funding markets and other potential disruptive effects as well as regulatory obstacles and/or practical implementation challenges. The report also acknowledges that because variable NAV

("VNAV") funds are not exempt from risks, especially when they use amortized cost accounting to value some or a large part of their assets, several recommendations would be relevant for both types of funds.

The report discusses a number of policy options, which are divided into four sections, aimed at "reinforcing the robustness and safety of money market funds." The report notes that these options are not necessarily mutually exclusive and some may be considered in combination. The pros and cons of each of the following options are described.

Section I: Mandatory move to VNAV and other structural alternatives

- Move to VNAV—prohibit the use of amortized cost valuation for any securities held by a money market fund.
- Impose NAV buffers on Constant NAV ("CNAV") funds, alone, or in combination with, for example, redemption restrictions. The report describes the following four variants of a NAV buffer requirement:
    - Market-funded NAV buffers—require funds to issue a subordinated equity share class;
    - Shareholder-funded NAV buffer (Version I)—require funds to create a shareholder-funded internal NAV buffer through retention of fund income that absorbs initial losses;
    - Shareholder-funded NAV buffer (Version II)—require fund shareholders to purchase a certain amount of capital securities as a condition of investment in the fund's constant value shares; and
    - Sponsor-funded NAV buffer—require fund sponsors to provide financial support for the funds that the sponsors implicitly assume.
- Require private insurance to resolve short-term cash shortages.
- Require money market funds to reorganize as special purpose banks with bank-like regulation.
- Permit both VNAV and CNAV funds, but with enhanced protection for CNAV—(e.g., require participation in a private liquidity facility or enhanced regulatory requirements).
- CNAV funds reserved for either only retail or only institutional investors.

Section II: Money market fund valuation and pricing framework

- Restrict the use of amortized cost accounting by money market funds through restrictions on the type of instruments (e.g., securities with a remaining maturity of 30, 60, or 90 days) or through the establishment of limits in terms of maximum deviation between amortized cost valuation and market value for each asset in the portfolio.

Section III: Options regarding liquidity management

- Require money market funds to hold a certain amount of liquid assets and restrict the amount of illiquid assets.
- Require money market funds to establish "know your shareholder" policies and procedures.

- Impose a liquidity fee based on certain triggers.
- Impose a minimum balance requirement on money market funds.
- Allow money market funds to value their assets at bid prices.
- Require redemptions in kind for large redemptions.
- Require/permit money market funds to impose gates.
- Require a private emergency liquidity facility to resolve short-term cash shortages.

Section IV: Options to address reliance on ratings

- Remove references to ratings from money market fund regulation and consider alternative standards.
- Improve the meaning of triple-A rated money market funds.

The report also includes an appendix that reviews the historical development of money market funds, their market significance and investor base, their role in funding markets, the experience during the 2007-2008 financial crisis, the changes to money market fund regulatory frameworks adopted since then, as well as a review of some of the recent literature on money market funds.

Jane G. Heinrichs
Senior Associate Counsel

endnotes

[*] IOSCO, Money Market Fund Systemic Risk Analysis and Reform Options: Consultation Report (April 27, 2012), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD379.pdf.