

MEMO# 35326

May 26, 2023

SEC Chair Gensler's Remarks Before ICI's Leadership Summit

[35326]

May 26, 2023

TO: ICI Members
Investment Company Directors
ICI Global Members
Accounting/Treasurers Committee
Bank, Trust and Retirement Advisory Committee
Broker/Dealer Advisory Committee
Chief Risk Officer Committee
CIT Advisory Committee
CIT Operations Subcommittee
Disclosure Working Group
Liquidity Rule Implementation Working Group
Operations Committee
Pension Committee
Pension Operations Advisory Committee
SEC Rules Committee
Small Funds Committee
Transfer Agent Advisory Committee
SUBJECTS: Compliance
Exchange-Traded Funds (ETFs)
Fixed Income Securities
Fund Accounting & Financial Reporting
Fund Governance
Money Market Funds
Municipal Securities
Operations
Portfolio Oversight
Risk Oversight
Transfer Agency RE: SEC Chair Gensler's Remarks Before ICI's Leadership Summit

At ICI's 2023 Leadership Summit, SEC Chair Gensler delivered remarks which focused on fund dilution and liquidity and how it relates to financial stability, outstanding SEC rule proposals related to money market funds and liquidity risk management, hard close, and swing pricing, and bank regulators' oversight of short-term investment funds (STIFs) and

collective investment funds (CITs).[\[1\]](#) Chair Gensler's remarks are summarized below.

Fund Dilution and Liquidity

Chair Gensler, following a brief discussion of some of the reasons that led to the enactment of the Investment Company Act and Investment Advisers Act and their benefits to investors, noted that the "1940 Acts along with SEC rules to implement them addressed the failures of the Depression-era investment funds and have lowered the risk of financial fires spreading from funds." He stated that "[t]hey've done so through fiduciary duty obligations, liquidity requirements, leverage limits, daily net-asset valuations, and pricing rules for sales and redemptions to help guard against dilution." He asserted, however, that "risk remains—particularly in times of stress," and that "[m]oney market funds and open-end bond funds, by their design, have a potential liquidity mismatch—between investors' ability to redeem daily on the one hand, and on the other, funds' securities holdings that may have lower liquidity." He further asserted that "in 2008 and 2020, sparks emanated from registered funds, particularly money market and open-end bond funds, putting everyday Americans at risk."

Chair Gensler then stated that "[i]n 2008, after one money market fund 'broke the buck,' the government's fire departments stepped in with extraordinary actions," and that "[a]t the onset of COVID-19, during the 'dash for cash,' again there were calls for fire department support both for money market and open-end bond funds—in other words, Federal Reserve support." Following a discussion of some of the governmental actions around March 2020, he concluded that "[a]s these real-world events demonstrate, stress on these funds is not unsubstantiated hypothesis."

After noting that "[l]iquidity and dilution management has been a bedrock principle of open-end funds since the passing of the Investment Company Act," he indicated that "[r]ecent events are a reminder there is more work to be done."

He then discussed the SEC's "proposals intended to address the structural issues and enhance liquidity risk management for both money market and open-end funds."

Money Market Funds

Chair Gensler stated that "[m]oney market funds and banks both are involved in the transformation of maturity and liquidity risk," and "policymakers over the years have put in place laws and rules to address such risks."

He went on to say that "[m]oney market funds are invested dollar for dollar in readily marketable securities—in essence, a narrow bank concept." He noted that "money market funds ... are not without risk," citing the "risk of runs and resulting dilution." He referenced the recent growth in money market fund assets alongside the potential for future additional growth given the potential for "consequential changes to the deposit and banking landscape," and said that "[t]his is all the more reason to update rules last addressed in 2014 to lower the chance the fire department, the Federal Reserve, has to be called in yet again."

He then described elements of the SEC's proposal on money market fund reform, noting that it "would prevent money market funds from imposing limits on redemptions in times of stress" and the "proposed enhanced liquidity requirements" "to better address pricing and reduce dilution in times of stress," and the proposed requirement for "swing pricing as well as alternatives regarding liquidity fees."[\[2\]](#)

Open-End Funds

Chair Gensler noted that "open-end funds also provide maturity and liquidity transformation" and stated that "the Federal Reserve in 2020 bought corporate bond ETFs ... to alleviate stresses in the markets." He stated that "[t]he [liquidity] proposal would establish minimum standards for liquidity classifications, designed to prevent funds from overestimating the liquidity of their investments." As to pricing, the SEC "put forward a number of alternatives...—either within the framework of swing pricing or liquidity fees—[that] are being considered with the goal that redeeming shareholders bear the appropriate costs associated with their redemptions, particularly in times of stress." The SEC also proposed "to shorten the lag between when investors' orders are placed and when the fund receives those orders," which in his view can lessen risk.^[3]

STIFs and CITs

Chair Gensler noted STIFs and CITs are exempt from SEC oversight and they lack requirements related to limits on illiquid investments and minimum levels of liquid assets, limits on leverage, regular reporting on holdings to investors, and board independence.

He stated that "[w]e know from history that financial fires can spread from regulatory gaps," and that "[s]uch gaps include when regulations don't treat like activities alike." He then noted that "[the SEC is] in discussions with the bank regulators on these topics."

Question & Answer Session

Following his formal remarks, Chair Gensler engaged in a robust question and answer session with ICI President and CEO Eric Pan covering: whether the SEC's proposal on open-end fund liquidity is intended to address dilution or financial stability concerns; the interest of the Financial Stability Oversight Council in both open-end fund liquidity and money market funds; and the breadth of the SEC's rulemaking agenda.^[4]

Joshua Weinberg
Associate General Counsel, Securities Regulation

Notes

^[1] See SEC Chair Gary Gensler, "Bear in the Woods" Remarks before the Investment Company Institute (May 25, 2023), available at <https://www.sec.gov/news/speech/gensler-remarks-investment-company-institute-05252023>.

^[2] ICI's memo on the SEC's Proposed Money Market Fund Reforms can be found at: <https://www.ici.org/memo33971>. A summary and copy of ICI's Comment Letter on this proposal can be found at: <https://www.ici.org/memo34107>.

^[3] ICI's memo on the SEC's proposed liquidity, swing pricing, hard close, and Form N-PORT amendments can be found at: <https://www.ici.org/memo34347>. A summary and copy of ICI's comment letter on this proposal can be found at: <https://www.ici.org/memo34960>.

^[4] The question and answer session can be viewed at: <https://vimeo.com/830432511/94e585bbcd>.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.