Occupy the SEC

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OWS Alternative Banking Group

alternativebanking.nycga.net

November 5, 2012

BY EMAIL

Timothy F. Geithner
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Mary Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Addressing systemic risk related to money market funds

Dear Secretary Geithner and Chairman Schapiro:

We are writing as members of the Occupy Wall Street ("OWS") working groups, Occupy the SEC and the Alternative Banking Group.[1] These groups' membership includes veterans of many segments of the financial services industry, including some of the major fund groups. Our objective is to bring that experience to bear on the central question of how to make finance work for the 99%, a group that includes shareholders of money market funds, taxpayers likely to be called on to fund emergency bailout measures and workers whose jobs might be at risk in the event of another crisis.

This letter is motivated by our concern about the systemic risks present in the money market fund industry, the proposals to address those issues, and the process being used to construct those proposals. We are particularly concerned that the interests of the 99% are not being incorporated into the process even though they are key stakeholders in this issue.

The President's Working Group on Financial Markets 2010 report emphasized that there are features of money market funds that make them a source of systemic risk susceptible to

[1] Occupy the SEC (http://occupythesec.org) and the OWS Alternative Banking Group (http://alternativebanking.nycga.net) are groups within the New York-based Occupy Wall Street ("OWS") protest movement. This letter represents the opinion of the groups' members, and does not represent the viewpoints of OWS as a whole.

destabilizing runs.[2] The 2010 SEC Money Market reforms were a necessary first step toward addressing these risks by tightening standards for liquidity, credit, duration and other factors. These reforms did not, however, address the systemic risks to financial markets these funds present. We were disappointed to learn the majority of Securities and Exchange Commissioners are opposed to choosing between the two alternatives described by the Chairman in her June testimony to Congress,[3] and unanimously supported by the Financial Stability Oversight Council ("FSOC") in July. We consider it essential that the FSOC and the SEC address these vulnerabilities.

Secretary Geithner's letter to the FSOC members[4] included a reminder of their obligation to "seek informed perspectives" and "engage with key stakeholders" in the process of developing regulatory proposals for these important investment vehicles, in keeping with Section 120 of the Dodd-Frank Act ("DFA"). The need for transparency in this process is particularly important given the precedent it is likely to set. This is the first time the FSOC has invoked its authority under DFA to make recommendations to a primary regulator. That measure requires that the FSOC consult with the primary regulator before seeking comment from the public.

That is why we were alarmed by revelations in the press on Friday, October 26 of closed-door meetings between the SEC, Treasury and members of the fund industry.[5] Closed meetings are especially troubling given press reports of the role that industry played in forestalling the SEC's proposed reforms this summer.[6] While the lack of public information on these meetings reduces us to speculation as to their content, the fact that one industry participant went so far as to call the leak of these talks "counterproductive" indicates an environment that runs counter to the spirit of regulation for the public good.[7]

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[2] President's Working Group Report on Money Market Fund Reform. Retrieved from http://www.sec.gov/rules/other/2010/ic-29497.pdf.

[3] Testimony on "Perspectives on Money Market Mutual Fund Reforms" by Chairman Mary L. Schapiro *U.S. Securities and Exchange Commission*. Retrieved from http://www.sec.gov/news/testimony/2012/ts062112mls.htm.

[4] Secretary Geithner Sends Letter to FSOC Members on Necessary Money Market Reforms. Retrieved from http://www.treasury.gov/connect/blog/Documents/Sec.Geithner.Letter.To.FSOC.pdf.

[5] "BlackRock, Fidelity Seeking Money Fund Deal with SEC", *Bloomberg*, October 26, 2012. Retrieved from http://www.bloomberg.com/news/2012-10-25/blackrock-seeks-money-fund-compromise-amid-fsoc-threat.html.

[6] "Major fund managers including Fidelity, Federated and Charles Schwab have rallied allies to oppose Ms. Schapiro's proposal. An industry group, the Investment Company Institute, said the supporters include 67 regional chambers of commerce, 105 House members and 10 state treasurers."
Changes to Money Market Funds Stall, *The New York Times*, August 22, 2012, Retrieved from http://www.nytimes.com/2012/08/23/business/sec-calls-off-vote-on-fund-regulation.html?pagewanted=all.

[7] 'Several money market fund providers said they were unhappy that news of the meeting was made public. The leak is "counterproductive" to the negotiations, according to one executive at a money market fund firm who

It is also counter to the spirit of the FSOC's mandate. Rather than working solely with the primary regulator to develop recommendations for public comment as required by Section 120(b)(1), these reports indicate that the FSOC is prioritizing the industry's views in developing its recommendations before the public has a chance to comment. This unwelcome alignment between regulators and the regulated is most obvious in the parallels between Secretary Geithner's letter to the FSOC and a key industry proposal from BlackRock.[8] In addition to being released on the same day (September 27, 2012), the third option introduced by Secretary Geithner's letter can be read as a high-level summary of elements of the plan proposed in greater detail by BlackRock. This appears to be another example of giving the financial industry preferential influence in the process of rulemaking, one that risks making the public comment process a mere *ex-post* formality.

Nonetheless, we intend to participate in the process laid out in the Act by providing detailed comments once the Council has arrived at its proposed recommendations. In advance of those, we offer a summary of the regulatory principles we believe are important to the key participants we engage with:

> *Fairness:* The costs of insuring against systemic risk should be shared across all key stakeholders. Moreover, all money market fund shareholders should be subject to the same requirements. Institutions should not have advantages over individual investors, and early redeemers should not be able to do so at the expense of those remaining in the fund.
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> *Transparency:* The risks inherent in a given investment should be visible to those investing, as well as to regulators. The current approach of maintaining fund NAVs at $1.00 makes it impossible for fund shareholders to assess portfolio risks, while the assumption of fund sponsor support for a stable NAV masks the reality that such support is discretionary. This principle implies that the accounting and reporting methodologies employed by the funds should reflect the actual current market value of the underlying investments, and that any NAV support should be made explicit.

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requested anonymity because of the sensitivity of the discussions.'
BlackRock, others in talks on money market compromise" Reuters, October 26, 2012. Retrieved from http://www.reuters.com/article/2012/10/26/us-blackrock-moneymarketreform-idUSBRE89P0TV20121026.

[8] Money Market Funds: A Path Forward: BlackRock Viewpoint, September 27, 2012. Retrieved from https://www2.blackrock.com/webcore/litService/search/getDocument.seam?venue=PUB_IND&source=GLOBAL&contentId=1111173537.

> *Value:* Financial innovation needs to add value to society, not simply to produce profits for finance. We believe that money market funds provide useful services for individual investors.

The necessity for a public voice in the process is abundantly clear when these principles are applied to proposals emanating from the industry. BlackRock, which has been mentioned in press reports as taking a leading role in meetings with regulators, has posted their most recent recommendations to their website. Their proposal dismisses the two original SEC options of floating NAVs and capital buffers. While we agree these measures were not perfect, they were aligned with our principles. A floating NAV would create significant transparency, and would also enhance fairness by making the same information available to all investors. A capital buffer, if coupled with appropriate risk-sharing, would ensure that the cost of NAV stabilization in a period of crisis would be shared among stakeholders.

BlackRock instead proposes enhanced disclosures that would impose minimal costs on the industry, coupled with a redemption fee that shifts the costs of stabilization onto slower-moving fund shareholders. They recommend that sponsors levy 'stand-by liquidity fees' (SLF) to be paid by redeeming shareholders once the mark-to-market NAV falls below a target level, at which point those seeking to protect capital by selling their shares would pay a fee that doubles their losses. While it does appear that paying those fees back into the fund would ultimately stabilize the NAV under certain assumptions, such a structure would exacerbate the existing incentives for investors to flee at the first sign of trouble by making it potentially far more expensive to redeem later. It would also leave the remaining shareholders with a harsh choice between remaining in the fund in hope of a recovery, or doubling their losses by exiting.

We urge the Council to consider alternate measures that impose costs more fairly, as well as those that enhance transparency, in order to maintain the value of money market funds for the average investor. The status quo of discretionary commitments by fund managers to stabilize falling NAVs, coupled with the ad hoc nature of the 2008 government guarantee program, creates uncertainty and also contributes to the misperceptions of security that Chairman Schapiro warned of in her June testimony. This misperception has been a significant benefit in terms of attracting assets to the fund management industry, which has further clouded the issue by offering banking features such as checks and ATM cards. To the extent that the industry intends to continue promoting bank-like features, we urge the Council to consider imposing a more bank-like regulatory regime. One possibility would be to institute an industry-funded guarantee program modeled on the 2008 temporary program. Another possibility would be to replace the current practice of implicit but discretionary commitments by fund sponsors with a clearly defined obligation to disclose the magnitude of loss they would cover, as well as the conditions under which it would be triggered. Such measures would give shareholders a clearer understanding of what they can, and can not, expect in the event of a crisis.

The potential for another run on money market funds remains, even as the Dodd-Frank Act has closed the door to the extraordinary measures taken in 2008 to stabilize the short-term funding markets. It is thus imperative that regulations be put in place to address this systemic risk before the next crisis, and that these regulations be developed following a transparent process that incorporates the interests and concerns of all stakeholders at all stages, not only during comments. To that end, we look forward to further dialogue on the Council's recommendations when they are complete. We will make our communications and recommendations public. We ask that the SEC and Treasury do the same.

Sincerely,
/s/
Occupy the SEC
OWS Alternative Banking Group

George Bailey
Nikki Leger
Nicholas Levis
Cathy O'Neil
Anchard Scott
Yves Smith
Josh Snodgrass
Akshat Tewary
et al