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Obama Administration Recommends Reform of Money Market Funds

By Joan Ohlbaum Swirsky

The Obama administration (the administration) has recommended that the SEC "move forward with its plans to strengthen the regulatory framework around money market funds," including moving to consider some of the reforms proposed by the Investment Company Institute (ICI) in its Report of the Money Market Working Group released March 17, 2009. The administration also proposed that more fundamental changes be considered, including, for example, moving away from the stable net asset value (NAV) of money market funds or requiring money market funds to "obtain access to reliable emergency liquidity facilities from private sources." Under the administration's recommendations, the President's Working Group on Financial Markets (PWG) would consider the more fundamental changes in a report to be completed by Sept. 15, 2009, which "could include" those changes. The PWG is an informal working group comprised of the Secretary of the Treasury and the Chairmen of the Federal Reserve Board, the SEC, and the CFTC.

The administration's recommendations are set forth in an 85-page draft "White Paper" released today that includes far-reaching recommendations for reform throughout the financial markets. The money market fund recommendations comprise about a page and a half of the White Paper.

The less fundamental reforms that the administration said the SEC should consider are:

1. requiring money market funds to maintain substantial liquidity buffers;
2. reducing the maximum weighted average maturity of money market funds;
3. tightening credit concentration limits;
4. improving the credit risk analyses and management of money market funds; and
5. empowering money market fund boards of directors to suspend redemptions in extraordinary circumstances to protect the interests of fund shareholders.

Each of these recommendations parallels a similar recommendation or recommendations, which were included in the ICI Report, except the recommendation to "tighten credit concentration limits," which does not appear to have a direct parallel in the ICI Report. While the ICI Report did not focus on credit "concentration," it did include a recommendation to forbid money market funds to purchase holdings rated in the second tier by rating agencies (rather than only first tier holdings).

The White Paper states that these measures should enhance investor protection and mitigate risk of runs on money market funds; but these measures, by themselves, should not be expected to prevent a run on money market funds of the scale experienced in September 2008. The administration states that the PWG's recommendations would address systemic risk more directly.

For liquidity facilities to provide money market funds with meaningful protection against runs, the facilities should be "reliable, scalable, and designed in such a way that drawing on the facilities to meet redemptions would not disadvantage remaining money market fund shareholders." The administration says that the SEC and the PWG should carefully consider ways to mitigate any potential adverse effects of such a stronger regulatory framework for money market funds, such as investor flight from money market funds into unregulated or less regulated money market investment vehicles or reductions in the term of money market liabilities issued by major financial and non-financial firms. The ICI Report had mentioned investor flight to less regulated stable cash vehicles as a risk of allowing money market fund NAV to float.

The administration's suggestion that the NAV of money funds could float is not surprising, given that the Group of Thirty issued the same proposal on Jan. 15, 2009 in its report on financial reform. The Group of Thirty is a private, nonprofit, international body composed of very senior representatives of the private and public sectors and academia, including several advisers to President Obama. A floating NAV for money market funds also has been discussed recently by various administration officials, including Mary Shapiro, Chairwoman of the SEC and Andrew Donohue, Director of the SEC Division of Investment Management. The ICI and many others in the industry have voiced opposition to that suggestion. The SEC is expected to propose amendments to Rule 2a-7, the money market fund rule, later this month, and it is not known whether the floating NAV will be included in that proposal. The White Paper leaves flexibility as to whether the floating NAV will be pursued, as it states that the floating NAV is an "example" of a reform that the PWG "could" propose.

The White Paper does not discuss certain other controversial proposals that had been included in the Group of Thirty Report, such as creating a money market fund that operates as a bank-like product, with government insurance and access to central bank lender-of-last resort facilities. ■

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