U.S. Chamber of Commerce

Money Market Fund Reform

Remarks by:
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Location: Washington, D.C.

Date: Wednesday, February 8, 2012

Transcript by
Federal News Service
Washington, D.C.

SENATOR PAT TOOMEY (R-PA): Good morning. Thank you very much, David. Thanks for having me here. I want you to know that every one of my Senate colleagues is jealous that they don't get to address the question of the regulation of money market funds at 8 o'clock in the morning. (Laughter.) But I do. And I'm actually glad to do this.

You know, I have a little bit of a background in financial services myself. The first career that I had when I got out of college was in New York on Wall Street. I was in the capital markets side of the banking industry and actually played a role in the early development of the fixed income derivatives market. So I have the distinction of being the only member of the U.S. Senate, maybe the only member of Congress, who is a former derivatives trader. And I'm quite certain I'm the only one who admits it. (Laughter.) But thanks for having me.

I was asked to talk a little bit about the regulatory atmosphere, that which is – appears to be coming. Of course the article yesterday on the front page of the Journal certainly does make this very timely, as David observed. Look, my own view – I like to disclose my biases upfront – I happen to think that money market funds are a very, very important part of today's financial marketplace. I think that money market funds are under attack. I think there is a concerted effort to impose very, very, very troublesome regulations that, in some cases, I think do threaten the viability of the product itself. I think that is not by accident. And I think we should push back very aggressively, because in the absence of this product, our financial markets will be less liquid. I think they will have fewer choices. And I think we will all pay a price, both investors and borrowers, for that.

So let me – let me walk through a few of the observations that bring me to that conclusion. And I'll be – I hope we'll be able to maybe take a couple of questions at the end. First thing that I think we ought to remind folks – and I know you guys are going to be out on the Hill, I think, later today. You've probably already had conversations. And I hope you will take the occasion to remind my colleagues about just how well money market funds have functioned for the 40 years that they've been around. It's really a very impressive history, it seems to me, of safe, steady and predictable mechanism by which millions of investors have been connected to thousands of borrowers. It's a huge scale that you know very well – 30 million investors, I'm told something on the order of $2.6 trillion dollars in assets. And it's very diverse. I'm not sure all my colleagues appreciate the range of instruments, from ordinary commercial paper to asset-backed paper to treasurers to munis. The full range of short-term debt instruments that money market funds participate in is important.

I think the business model, the very mechanism by which the managers of money market funds – by which they operate, by which they make the connection between the investor and the borrower and not through a banking type of intermediation but rather through direct purchases is part of the reason that you just have a business model that enables greater efficiency. You've got lower overhead, and so borrowers have a lower cost of funds and investors get a better return on their investment. And so therein lies the obvious appeal of the – of the instrument.

As far as the safety goes, my understanding is, over the 40 years during which money market funds have been in existence, there have been over 2,800 bank failures at a cost of something approaching $200 billion to the federal government. And during that time, I'm aware

of only two money market funds that were unable to redeem their investors' money at 100 cents on the dollar. One was done at 96 cents on the dollar, and the other at 99 cents – a little over 99 cents on the dollar – no cost to the government and really extremely modest loss in very, very few cases to the shareholders. And that's part of why I was a little disappointed at the way The Wall Street Journal article yesterday characterized some of these reforms.

I saw very early on in the article, the writer – the reporter described these proposed regulations as necessary to shore up the industry. It was not obvious to me that the industry was sort of listing to the side and badly needed to be shored up. The other – like the next paragraph, it said that this set of regulations comprises of a two-part plan meant to stabilize – and that's the word they used – to stabilize the industry. Maybe you're aware of something that I'm not, but it is not clear to me that this is all that unstable an industry. The exception, of course, that everybody will point to and that justifies – in the minds of many of the regulators, that justifies this action really, I think, centers around the Reserve Primary Fund, you know, a very well-known case that was a very exceptional case.

But really, there's been nothing similar in the history of money market funds. The Reserve Fund – and we could have a whole discussion about what happened there, but I think it clearly had to do with excessive concentration to Lehman Brothers' paper and an extraordinary financial crisis that had a devastating impact on all kinds of financial institutions. So it's not clear to me that an extremely exceptional event like that – and one in which, by the way in the end, investors got 99 cents of every dollar they had invested – it's not clear to me that we ought to have an entire regulatory regime based on such an extraordinary exception.

But nevertheless, as we all know, in 2010, there was a new wave of regulations that were imposed which, whether you agree with them or not, I understand the logic behind the idea of addressing liquidity as a way to minimize the risk of a run and maximize the ability of a fund to withstand, you know, heavy redemption pressure. And so you've got the 10-day – I'm sorry – the 10 percent of holdings that are required to have daily liquidity and the 30 percent within 5 days.

And it's interesting to note – and again, I would urge you to remind my colleagues – that under these regulations, money market funds have already weathered some pretty tough additional storms. Right? The emergence of the European debt crisis last summer was very, very disruptive. And there's no question, money market funds had a – significant investments with European banks. And despite that, they got through that storm really remarkably well.

By the way, that was also around about the time that the debt of the United States government was downgraded, right – a completely unprecedented, shocking event in many ways. And, as it happens, during July and – June and July of last year, there was a very significant level of redemptions. As I understand it, over 10 percent of the prime money market fund investments were redeemed, over $167 billion – in some cases, as much as 20 (percent) to 40 percent of individual funds.

And yet not a single money market fund broke the buck. None faltered; there were none that were unable to meet the redemption requests. The reforms that were imposed in 2010

evidently worked reasonably well. It seems to me, this is evidence that this is a pretty safe product, even during times of considerable stress.

So now we discover – and obviously we've been concerned about this for some time now – that there is yet a new wave of regulations that is being very, very seriously considered. And I think – well, I think it's – there's several regulatory bodies that are very supportive and pushing this. I think the Fed is one of them, let's just be clear. It's the SEC that may oppose it, but the Fed is – has, I think, long sought to change the way money market funds operate, to say the least. Senior Fed officials have described money market funds as part of the shadow banking system, which I think is meant to be a pejorative term that suggests that they're unregulated. That will come as news to the SEC and to many of you, that this is an unregulated industry; but that's how they view it.

So I think a lot of the pressure is coming from that direction. I think Fed Governor Tarullo has even said that, in the absence of new regulations, money market funds could get the SIFI designation, which I think would be – is inappropriate. But this gives you a sense of where the mindset is. And Secretary Geithner cited as a success the fact that money market funds had shrunk since their 2008 peak. So again, it's not clear to me why that ought to be perceived as a success. But it speaks to his mindset on this.

So I just want to touch briefly on some of the specific ideas that appear to be about to be visited upon us, and share with you my concerns about them. The first is one of the – it's been kicking around for a long time, I suppose, which is floating the NAV. And it seems to me that this idea is one that strikes at the very heart of this product. At the very heart of this product is the convenience and the predictability and the stability of a fixed NAV. I think that's a big part of what attracts investors, a big part of the source of liquidity and attractiveness as a cash-management tool. And I think there are some big problems if we depart from that.

First, I – my understanding is, there are many institutional investors that are prohibited from investing in vehicles that have a floating NAV. So they'll be forced to withdraw. I wonder to what extent the regulators have considered the exodus from the funds that they could cause if they proceed down this road.

The second point is, it's not clear to me that floating the NAV reduces the risk of runs on money market funds. It's not clear that that would mitigate the liquidity crunch that we had in 2008. And my understanding is that there are instruments that have had a floating NAV in Europe that did experience runs, despite the floating NAV. So it's not clear that that's a great solution.

It is clear that there's a big problem with the tax treatment. That is – you know, the fact that every sale could become a taxable event and has to be recorded and accounted for – clearly that would be a huge detraction for many, many investors, and diminishes the appeal of this. So I think this regulation would be very, very problematic for the product. And it seems – it – well, let's just say it's not clear to me how it deals with improving systemic risk. And so it's not clear that it's a good idea.

The redemption restrictions and the holdback provisions that are also being discussed – my understanding is, some suggestions are that we could force investors to leave as much as 5 percent in the fund for 30 days after a redemption. Again, this just changes the fundamental nature of the product. The purpose of the product is for people to feel they've got their cash there to be withdrawn at any moment when they need it. And if they can only get a certain percentage of it back, I think it dramatically undermines that appeal.

And then the last one is this idea of capital buffer requirements. What – I just haven't seen how the math works. In a basically zero-percent interest rate environment, where the yield for ordinary investors is so low, how many basis points are available to use to create the higher return you need for a capital cushion? Now if the fed funds rate were 8 percent – and, you know, the long bond were yielding 10 (percent) or something – well, then maybe there's a way that that works. But when fed funds are at zero (percent) – and all the way out to 10 years on the treasury the yield is below 2 (percent) – again, it's not clear to me that the math works. And it's not clear to me that it's necessary.

So, you know, my concern is that if these regulations are actually enacted, this – if most or much of this comes to pass, it really threatens to wipe out this product. I mean, I think it really goes to an existential threat over this product. In the process, of course, it would tend to drive a lot of money to banks – which is exactly the intent of some of the regulators. But again, I think we ought to ask whether that's such an optimal outcome. I know those who control the banks like that idea.

But that means that banks have to go out and raise a whole lot of additional capital at a time when that's a – that's a tough exercise for a lot of banks. It further concentrates assets in our – in our banking system, arguably exacerbating some systemic risks. And because we would be taking one whole business model out of the equation and asking – you know, forcing our financial markets to rely just on the bank intermediary activity, I think it's very likely to drive up costs for borrowers, drive down returns for investors, provide less liquidity, fewer options. There'd be a huge transition problem, because obviously the money market funds plays such a big role in the commercial paper market itself.

So I think this is very problematic. It comes at a bad time, given the stresses that are still evident across our banking system, and in particular with interest rates as low as they are. So given this threat – you know, given the totality of this – my own view is that whatever risks are inherent in money market funds – and any kind of investment activity has some level of risk – but given the risks as they exist today, it's just not clear to me that they justify this regulatory regime that's been described in the press and that I'm – I fear is heading our way.

So, in anticipation of some of this, my – some of my colleagues and I have been active in trying to push back; trying to slow this down; trying to force a rational, considered judgment about these regulations before they're imposed. We sent a letter to the SEC last November asking them not to rush ahead with adoption of these regulations. I've personally met with regulators, many of them, to discuss this and to express my concern. I've asked specific questions at the Banking Committee hearings. But all of this does not seem to have appreciably slowed the process, and it looks like it's still coming. So I think we need to stay very, very

engaged in this. It's important to me that our investors and borrowers continue to have access to this very important tool.

So if we do see a new wave of regulations – some combination of those that I've just described – there's a few things that I think we can and should do. One is, as a member of the Banking Committee, I would intend to insist that we have some hearings to give as much public scrutiny as possible to this; make sure that my colleagues understand that this isn't just a problem for the people who are in the business of running a mutual fund. This is a problem for the investors and the borrowers who use this mechanism.

I will continue to meet with folks over at the SEC to press my case. I want to see what kind of cost-benefit analysis has led them to the conclusion that the costs – which seem to me quite substantial – are justified by the benefit. And I want – I want to see how they've done that and challenge their methodology. And if necessary, I wouldn't rule out introducing legislation that would push back and ensure that we can continue to function.

I'm a big believer that a dynamic economy is one in which the market gets to sort out and gets to pursue many different ways of providing goods and services. And having the government come in and, through an extremely onerous regulation, just basically foreclose some options and force the market to behave in the way that certain regulators approve of – I generally take a very skeptical view to that. This is no exception.

I appreciate – many of you I've had a chance to work with on this issue and others, and I appreciate that working relationship. And I look forward to continuing it. So thanks for having me this morning. (Applause.)

(Off-the-record question-and-answer session.)