FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT BROKER-DEALERS AND INDEPENDENT FINANCIAL ADVISORS

STATEMENT FOR THE RECORD

On

The U.S. House Committee on Financial Services,
Subcommittee on Capital Markets and Government Sponsored Enterprises

"Oversight of the Mutual Fund Industry: Ensuring Market Stability and Investor Confidence"

June 24, 2011

FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT BROKER-DEALERS AND INDEPENDENT FINANCIAL ADVISORS

Statement of the Financial Services Institute To the Subcommittee on Capital Markets and Government Sponsored Enterprises For Oversight Hearing on Issues in the Mutual Fund Industry

The Financial Services Institute (FSI) represents independent broker-dealers (IBD) and the independent financial advisors affiliated with them. We are pleased that the Subcommittee is holding this hearing to explore the issues facing mutual funds and their investors. We wish to register our concerns regarding proposed changes to the structure of money market funds, particularly our strong opposition to proposals that would force these funds to abandon their stable $1.00 per-share price and instead "float" their net asset values (NAVs).

The Importance of Money Market Mutual Funds to Main Street Investors

We are deeply aware of the value money market funds provide to investors—middle-class Americans, businesses, non-profit institutions, and state and local governments—because these are our clients. Since the financial crisis of 2007–2009, policymakers have made great progress in making money market funds even stronger. A few regulators and commentators, however, continue to advocate changes that would undermine the economic and investor benefits of money market funds by eliminating the stable $1.00 per-share price. In our view, forcing money market funds to float their NAVs would harm investors and the broader U.S. economy. Therefore, we strongly support maintaining the ability of money market funds to offer a stable $1.00 per-share value.

For the independent broker-dealers and financial advisors we represent and the investors whom they serve, money market funds provide a high degree of liquidity, diversification, and convenience, along with a market-based yield. The stable NAV is central to these benefits. Investors purchase and redeem millions of dollars in money market fund shares every day. With a stable NAV, typically set at $1.00 per share, those investors are relieved of the burden of tracking gains or losses for tax or financial accounting purposes.

To force floating NAVs would take away these benefits while risking the following negative effects:

- **Hobbling cash management**. Many governmental bodies, businesses, and institutions operate under legal constraints or investment policies that prevent them from investing cash balances in instruments that fluctuate in value. If money market funds were required to float their NAVs, many clients of independent broker-dealers and financial advisors would be forced to use alternative funds that are less regulated, less secure, and less liquid.
- **Driving up the cost of investing and doing business**. Individuals, businesses, and institutions use money market funds to hold excess cash for short periods of time and maximize liquidity. Floating the NAV would undermine the convenience and simplicity of using money market funds for cash management by confronting businesses with new tax, accounting, and legal

hurdles. With a floating NAV, every money market sale would be a tax-reportable event, substantially increasing tax and recordkeeping burdens and significantly reducing the benefits of money market funds to Main Street investors.

- **Increasing the cost of financing.** Money market funds hold more than one-third of the commercial paper that businesses use to meet short-term obligations, such as funding payrolls, replenishing inventories, and financing expansion. If proposed reforms drive investors out of money market funds, the flow of short-term capital to businesses will be significantly disrupted.
- **Depriving investors of tax-exempt income and state and local governments of needed financing.** Mutual funds, including money market funds, can pass the benefits of tax-exempt income to investors—a feature that banks and other packaged investment products cannot provide. This has helped create a robust market in municipal securities to meet the capital and operating needs of America's communities. As the short end of that market, tax-exempt money market funds hold more than $300 billion in assets, accounting for more than half the short-term securities issued by state and local governments. Driving investors away from money market funds will hurt both investors and state and local governments.
- **Creating a financing gap**. Few immediate substitutes are available to fill the financing gap that would be created by a rapid shrinkage of money market funds. Even if banks could raise the new capital needed to meet corporate and municipal demand, the lending market would be less efficient and costs would rise. Alternative funds are less regulated, less secure, and less liquid.

To avoid these negative consequences, we believe that any further reforms for money market funds must preserve their fundamental features. As Treasury Secretary Timothy Geithner said recently, any further changes to money market funds must be made "without depriving the economy of the broader benefits that those funds provide."

Forcing the adoption of floating NAVs for money market funds would not make these funds more resilient under adverse market conditions, and it would destroy many economic benefits. Therefore, we oppose any proposals that would change the stable $1.00 value of money market funds.

We thank the Subcommittee for holding this hearing and for the work it is doing to address these issues. Please contact David T. Bellaire, Esq., FSI's General Counsel & Director of Government Affairs at 770 980-8488 or david.bellaire@financialservices.org if you would like more information on the Financial Services Institute and our position on this important issue.

Background on FSI and the Independent Broker-Dealer Community

The IBD community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 financial advisors – or 64% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees of their affiliated broker-dealer firm.[1] These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market for advisors affiliated with IBDs is clients who have tens and hundreds of thousands, as opposed to millions, of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[2] Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. Our mission is to insure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. We also provide our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

[1] Cerulli Associates at http://www.cerulli.com/.
[2] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisors.