SEC's Schapiro Still Eyeing Money Market Fund Changes

On May 11, Mellody Hobson, President of Ariel Investments, interviewed Mary Schapiro, Chairman of the SEC, at ICI's General Membership Meeting. An excerpt of their conversation is transcribed below.

MELLODY HOBSON, PRESIDENT, ARIEL INVESTMENTS AND MARY SCHAPIRO, CHAIRMAN OF THE SEC, AT ICI'S GENERAL MEMBERSHIP MEETING.

MELLODY HOBSON: It's no secret the SEC and the industry—the mutual fund industry—are at loggerheads over this issue of money market funds. We all know where we stand, so let's not debate that. How do we solve this?

MARY SCHAPIRO: Well, we do all know where we stand, I think, although I have to say, and I actually want to say thank you. There are a lot of people in this room who come to talk to us and even in the last couple of weeks, about these issues, about how do we speak the same language and broach the differences and find a way forward that's constructive and positive and collaborative. And I think that's wonderful and I really applaud those funds that have been in to talk to us about that.

Obviously I think we have a very legitimate concern about the risks that are posed by the stable NAV and the potential to cause runs. And it's not hypothetical and we all know what happened in 2008. And we all know, I think as well, that but for the Treasury stepping in and creating the guarantee program—and I was at FINRA, I was very closely watching what was going on here. It had profound impacts, of course, on broker-dealers and advisers, as well as investors. We know what happened when Reserve broke the buck. We know that it was really the Treasury and the Fed stepping in that stopped the run and we also know that the tools to do that are gone; they do not exist any longer. Congress made it clear that there wouldn't be that safety net available again.

So we want to confront this issue and we want to have a very open dialogue. We want to put some concrete ideas out there for people to react to. We want to put out an informative, useful cost-benefit analysis. We want to talk about what happens if we go forward with a capital buffer. What happens if we try to go to a floating NAV? What are the other possibilities that exist to deal with these issues, and have an honest and open debate. And I hope that that's what we will be able to do, ultimately. And frankly, we're counting on the industry to engage constructively in that debate and discussion with us.

HOBSON: Does that mean that there's more room for discussion, and the lines that have been drawn are not drawn in ink?

SCHAPIRO: Well, nothing is ever in ink until it's—even when it's been proposed it's in ink in a sense that it's been proposed, but it's certainly not final.

And my view is, and I think a lot of you know this, I am always open to having discussion. And we've had fund firms in this week—talking about these issues. So yeah, there's always the opportunity to shape a proposal. There are always questions that we ask in our proposals about—is this a better way, is that a better way? Here's the core problem we're trying to solve. It's real, it's happened, we have to be worried about this. Here's how we think we should solve it; you tell us what you think about it. And do it in as constructive as possible a way.

You know, one of the things that happened coming out of 2008 and the financial crisis, and I was a regulator then, so I am very attuned to this, is lots of commenters said, "Where were the regulators?"

"They saw risks building in the system. They saw tremendous flaws in the regulatory system, whether it was how the SEC supervised these very large investment banks that were not bank holding companies, whether it was what was happening in the housing markets, whether it was what was happening with mortgage servicing—whatever the issues were, where were the regulators? They saw these risks were building and they didn't ring the alarm bells."

And we have to learn that we can't sit by when we see what we think are genuine systemic risks in the system and not at least have the discussion and raise the issues. So I think that's what we're doing. I think that's what I'm required to do. That's what I took an oath of office to do, is say, "I see a problem, I think it's [money market funds] a threat to our system, how can we try to fix it?"

HOBSON: So I think from our perspective, there's no question that we think regulation has made our industry a better industry. And if you look at the long history of the fund industry, it's been largely an unblemished history. Largely—I mean, we've had some bumps in the road along the way there. But we've really done what we said we would do for the investor. And in working with the SEC, we've never sort of dug in like this, and you haven't had that kind of relationship with us. How does that affect your thinking, like, they've never taken this kind of stance before?

SCHAPIRO: You know, look—the ICI and the SEC have historically had a really constructive relationship. And look, you have a very important voice. In some ways, you speak for 90 million Americans who own mutual funds and this is the way into investing and participation in capital markets for most people in our country, 45 percent of households. So you have a responsibility, I think, to speak for those people. You're also businesses; we understand that. You have in some cases shareholders and other pressures. But you also have a unique opportunity to speak for people who don't otherwise have a mechanism through which to be heard on issues of real importance to investors.

And we appreciate that there is great passion around this issue of money mark fund reform, and the debate and the dialogue has been more dug in—to use your word—and strident, I think, than we've seen on some other issues. It has not gone ignored at the SEC. I mean, I notice it. We walk through the subway station; we see the signs. We don't think they're very effective, but we see them. I guess we're wonkish enough that we would really prefer a 50-page comment letter than a little sign over the fare card machine and Metro.

HOBSON: Do you go back to the office and talk about that?

SCHAPIRO: Not a lot. I mean, we're so busy that I actually thought our spokesperson had the best comment of all time, which was, "We look forward to trying to fit the Metro station into the public comment file." And I don't take the Metro so it was all actually lost on me, but some employees do take pictures. So we understand the passion around this issue. But I think that doesn't mean we can't confront it, and we have to deal with it.

HOBSON: Outside of money market funds—so let's put that aside for a minute—what keeps you up at night?

SCHAPIRO: Well, I will say I can't quite put money market funds aside. Every time, and this was clearly true through the summer, so let me quickly say that I think the reforms we did in 2010 were very good and very positive. ICI was a very constructive force with their report that I received very shortly after I arrived at the SEC that helped inform much of our thinking about the 2010 reforms. And they've worked well for what they were designed to do. But we [at the SEC] still come in every morning when there's been a problem and say, "What's the impact on money market funds?" Whether it's a downgrade of a European sovereign, whether it's the nuclear reactor issue in Japan, they all reverberate—all these issues reverberate—in the money market fund space. And so it's still a frequent question, you know, what's the exposure of money market funds?

Beyond that, I always worry about what we don't know and what we might be missing. And all you can do about that is to try to have great people who are thinking creatively, who are looking at the data, doing the analysis, and trying to keep us focused in the right places.

HOBSON: My last question on money market funds. In your perfect world, would they be smaller?

SCHAPIRO: You know, that's not for me to say and it's not for the government to say, quite honestly. They should be the size they should be. I want them to be resilient; I want them to be reflective of the fact that they are investment products and their value doesn't fluctuate. When I arrived—this has nothing to do with me—but they were $4 trillion and now they're $2.5 trillion. So I think it would be a fool's errand to try to say, "The right size is x." They should be what they should be, they should be resilient, and they should be strong; and investors should understand exactly what they are.