Proceed With Caution: Striking the Right Regulatory Balance for Money Market Mutual Funds

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Remarks as Prepared for Delivery by Nancy Prior, President, Money Markets, Fidelity
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Thanks, Brian. And thanks to iMoneyNet for hosting this event, and to all of you for participating.

It’s my pleasure to speak with you today about a product that plays such an essential role in fueling the American economy ... and which provides millions of American investors – large and small, sophisticated and novice, institutional and retail – with a convenient and reliable way to invest in the short-term markets.

As the largest provider of money market mutual funds, Fidelity is very much committed to ensuring the safety, stability and viability of this product.

Our money market fund portfolio management team is focused each and every day on researching and analyzing the short-term markets to help ensure that our funds can deliver – today and tomorrow, in stable and volatile markets – principal stability, ready liquidity and a market-based return that our shareholders count on.

We take our fiduciary responsibility to our shareholders very seriously. Our highest priority in managing money market mutual fund is maintaining the safety and liquidity of our clients' principal, and we are proud of our track record over the past 30+ years.

Ever since the SEC adopted a robust and comprehensive set of amendments to money market funds in 2010, Fidelity and the entire money market mutual fund industry have been actively engaged in deliberations about whether there is a need for further regulatory reform.

Over this three-year period, we have heard a range of viewpoints and recommendations from money market mutual fund investors, issuers, providers, academics and policymakers.

The debate has been open and transparent, with hundreds of hours of public meetings, voluminous comment letters online for all to see, and countless headlines and articles in the press.

I want to thank everyone who has been actively involved in this debate. It has certainly been a thorough process, some would say exhaustive!

But while differences remain as to whether additional reform is necessary and, if so, what the best approach might be ... we all share the same goals: to ensure the strength and stability of money market mutual funds and our financial system ... and to preserve the benefits that these funds provide investors, issuers and our economy.
I believe we are beginning to see a consensus emerge that could lead to a path forward ... a consensus across the various constituencies that have been actively involved in this debate – including, most importantly, the regulators. I will elaborate on that later in my remarks.

We at Fidelity support reform that could serve to strengthen the resiliency of money market mutual funds. But, as with any potential regulation, the expected benefits need to be carefully weighed against any potential harm or unintended consequences that might result from a change.

We believe that some of the structural changes being considered by regulators would greatly diminish the attractiveness of these highly effective and low-cost cash management vehicles, with potentially severe consequences.

On behalf of our shareholders, we have been – and will continue to be – vocal in our opposition to proposals that would undermine the core features that customers value in money market mutual funds while providing no benefit to the overall stability of the financial system.

We firmly believe that the 2010 amendments to Rule 2a-7 have made money market mutual funds more resilient ... and that further action is simply not warranted.

That's why our message to the Financial Stability Oversight Council (FSOC) is simple: take no further action on money market mutual funds at this time. The SEC is the regulator with the authority and expertise to consider whether and how to adopt additional reforms on money market mutual funds.

Furthermore, the alternatives the FSOC has proposed are not workable; and the FSOC has failed to meet the procedural and substantive requirements as well as the policy justifications that are necessary to exercise its authority to make such recommendations.

There is compelling evidence that the 2010 reforms, which Fidelity and the industry supported, have significantly improved the overall soundness of the funds and made them more resilient to market stress.

The reforms reduced risk in money market mutual funds by imposing stringent constraints on portfolio liquidity, maturity and quality, and through new requirements related to disclosure, operations, risk and governance.

The changes to liquidity requirements alone have made a hugely positive impact. Under the new rules, money market mutual funds are now required to hold roughly $800 billion in liquid assets,

Compare this to the $50 billion what was available through the Treasury Guarantee Program and the $152 billion that was outstanding through the Federal Reserve’s AMLF program during the 2008–09 crisis. And in fact, the actual liquidity levels in funds today are well above this $800 billion required level.

These reforms were tested in the summer of 2011, with the European debt crisis, the U.S. debt ceiling showdown, and the eventual downgrade of the U.S. by S&P. And the funds passed with flying colors.
More than $170 billion flowed out of money market mutual funds in an 8-week period, yet investors were able to redeem their money, sometimes up to 30% of a fund's total assets, without issue.

While the 2010 reforms have not been without costs – notably the reduced yield received by fund investors and the expense of new operational and reporting infrastructure incurred by fund sponsors – the changes have resulted in a far safer and more transparent product.

Our experience at Fidelity supports that conclusion.

In 2008, at the height of the Financial Crisis, our institutional Prime funds, like many others, experienced large outflows, more than we had ever seen.

Our recent stress tests have demonstrated that our prime funds can now handle in a single day outflows twice the size of the largest redemptions we saw over the course of an entire week at the height of the crisis.

Let me repeat that: In a single day, we can handle twice the redemptions we saw during the worst week in over three decades of managing money market mutual funds.

Another risk that our stress tests measure is changes in interest rates. Following the Lehman bankruptcy filing, key short-term interest rates rose by 29 bps in one day and 84 bps in one week. Those were big, historic moves.

Now fast-forward to today ... all of our Prime funds are ready for an interest rate move more than 10 times the worst day ever and nearly four times the largest move ever in a single week.

The results of these stress tests raise the question of how much protection is enough. We do not think removal of all risk from these funds is a desirable or realistic goal.

In addition to our own experiences, the recent SEC study done in response to questions posed by Commissioners Aguilar, Paredes and Gallagher clearly demonstrated that the 2010 reforms significantly reduced risk across all money market mutual funds.

The SEC study confirmed that not all money market mutual funds are the same – and that different types of funds perform differently during times of financial stress.

The Study, using industry data, confirmed our own experience – that most types of money market mutual funds were not subject to large abrupt redemptions during the Financial Crisis. In fact, the only type of money market mutual funds that experienced significant outflows in 2008 were Prime funds purchased primarily by institutional investors.

- During the one week period after Lehman filed for bankruptcy, Institutional Prime Funds lost 26% of assets, or just under $350 billion.

- Conversely, Treasury and Government funds actually had large inflows – over $185 billion on an industry-wide basis, or almost 30% of total assets.
• Muni funds had modest outflows of less than 5% ($26 billion)

• Retail Prime funds experienced less than 3% of outflows (or about $20 billion).

Based on the facts, data and empirical evidence, there simply is no justification, or benefit, for further reforms to Treasury, Government, Municipal or Retail Prime Money Market Mutual Funds.

Think about it: Why would a money market mutual fund that only owns U.S. Government securities and repurchase agreements backed by U.S. government securities ... the same securities that the Federal Reserve is aggressively purchasing in the markets, the most liquid and creditworthy securities in the world ... why would Treasury or Government funds ever need any additional reform?

Similarly, why would Muni money market mutual funds need additional reform? The entire muni money market industry is only approximately $265 billion. That's smaller than each of the largest nine U.S. banks. Muni money market mutual funds are hardly systemic.

Moreover, nearly 80% of the securities purchased by Muni funds qualify as weekly liquid assets – meaning that these funds can withstand significant shareholder redemptions – even though such large redemptions are highly unlikely since more than 70% of Muni money market mutual funds are owned by retail investors.

Furthermore, there is simply no evidence that Retail Prime funds could create or increase systemic risk.

Even the FSOC, in its Proposed Recommendations for money market mutual fund reform, acknowledged that redemptions during that historic week of record outflows were primarily prevalent among the more sophisticated, risk-adverse institutional investors, as institutional funds accounted for 95% of the net redemptions from prime funds.

As the FSOC and the SEC have noted, there are vast differences in portfolio composition, liquidity, and risk profiles across the different types of money market mutual funds.

Inexplicably, the FSOC failed to consider these varying levels of risk within each category of money market mutual funds and would apply their Proposed Recommendations to the entire industry, with very limited exceptions.

This is not a prudent and balanced approach to reform, and it risks imposing excessive costs on the economy and investors.

Unfortunately, no regulatory classification of funds as institutional or retail exists today. Money market mutual fund advisers self-classify funds and voluntarily report to iMoneyNet (our conference host) whether a particular fund is retail or institutional. Therefore, an important step toward creating properly tailored reform is to establish formal criteria that distinguish between these two fund types.

There are a number of ways to distinguish between retail and institutional funds. We encourage the SEC to analyze this issue further and to work toward a distinction in retail and institutional money market mutual funds, which would be helpful in tailoring reform based on empirical data.

But, more importantly, any regulatory changes should be narrowly tailored to address actual, identified risks.
We urge regulators to focus on the problems they are trying to solve – the ability of money market mutual funds to sustain large, abrupt redemptions in times of severe market stress.

Because Treasury, Government, Municipal, and Retail Prime Money Market Mutual Funds do not pose the liquidity, credit, and redemption risks that the FSOC and SEC have identified as a concern, these types of funds should be excluded from any additional reform measures.

And I believe we are beginning to see an emerging consensus developing around the realization that Treasury, Government and Muni funds do not need ANY further reform.

This viewpoint is supported by the SEC Study, which was a thorough and objective analysis.

It is shared by the Presidents of the 12 Federal Reserve Banks, as articulated in their joint comment letter to the FSOC.

And it is a point of view widely shared by many, many others who are closely following this debate.

Indeed, the comment letters filed in response to the FSOC's proposed recommendations on money market mutual fund reform show strong support for limiting further reform to Prime funds.

Of the comment letters that addressed the issue of distinctions across types of money market mutual funds, more than 95% agreed that Treasury money market mutual funds should be excluded from further regulatory changes; 86% said that government funds require no changes; and 83% held the same view for Muni funds.

The SEC should continue to review the results of its study prior to considering structural changes to money market mutual funds. And the Commission should clearly identify and thoroughly evaluate the costs and benefits of any additional regulations.

The fact is... money market mutual funds are already among the safest, most transparent – and most heavily regulated – investment products available anywhere.

These funds are just as regulated as banks, and far more transparent. Unlike banks, 100% of a fund's assets, line item by line item, are publicly available for all to see, regulators and shareholders alike.

Recently, Fidelity and other fund sponsors have begun providing even greater transparency by disclosing their portfolios' per-share market values on a daily basis.

Money market mutual funds are subject to strict liquidity, maturity and credit restrictions. They can invest only in issuers that represent minimal credit risk. They don't engage in leverage or risky financial activity. They are not permitted to have foreign currency risk, invest in long-dated, lower-quality securities, or engage in credit default swap transactions.

The regulation of money market mutual funds and bank products are quite different, which makes perfect sense, since money market mutual funds are investment products under the securities laws.
The banking regulatory scheme is not better nor does it provide more systemic safety than does the capital markets regulatory scheme.

Indeed, experience shows that banks’ capacity to perform the necessary credit and quantitative research, liquidity management and overall risk management is not infallible. In fact, more than 450 banks have failed since the Financial Crisis began.

The bank regulatory model of prudential regulation and government guarantees is not the only model, and we believe the financial system is better off having multiple, non-homogeneous oversight models. This is among the many, many reasons why requiring capital for money market mutual funds in not an appropriate solution.

Both regimes should co-exist to improve competition and drive market discipline.

Why do millions of individual and institutional investors continue to choose money market mutual funds to manage their cash balances, investment transactions, and portfolio allocation?

Because these funds are conservatively managed, highly transparent, and, since the 2010 reforms, have proven to be resilient in the face of extraordinary market stresses and shareholder activity.

That's why, despite the ongoing extremely low interest rate environment, individual and institutional investors have over $2.6 trillion of their cash invested in money market mutual funds.

Fidelity manages over $430 billion of that total. We take our fiduciary responsibility to our money market mutual fund shareholders very seriously. We have an experienced team of over 85 fixed income investment analysts based in the US and London who are responsible for performing credit analysis on every security we purchase.

We make an independent credit assessment for each investment, which includes a thorough, fundamental credit and cash flow analysis of the issuer, including its profitability, capitalization, cost structure, debt load, interest-rate sensitivity, capital intensiveness, sources of revenue, quality of assets and nature of liabilities.

No one cares more about the strength and stability of the money market mutual fund industry than we do. We remain open to new ideas and creative thinking about the best way to improve the resiliency of money market mutual funds. Yet, in support of our shareholders' best interests, we remain steadfastly opposed to changes that would eliminate the core features that investors value in money market mutual funds.

That said, we recognize that some policymakers strongly believe that further regulation is needed, and we appear headed down that path.

In that case, we respectfully call on the SEC to ensure that any further reforms of money market mutual funds be consistent with the goal of creating a stronger, more resilient product ... and do not impose harmful, unintended consequences on financial markets or the economy.

We should not regulate for the sake of regulating.
If additional regulation is necessary, it should be narrowly tailored to address a clearly identified problem.

The only issue that has been identified is that Institutional Prime Money Market Mutual Funds (and not any other type of money market mutual funds) can be subject to large, abrupt redemptions in periods of extreme market stress.

The SEC should consider a prudent and balanced regulatory response to this narrow issue.

A floating NAV is not the answer. It would impose burdensome tax, accounting and recordkeeping requirements for investors. Moreover, there is no evidence to suggest that it would prevent outflows in a crisis. It won't reduce risk in the system.

Always-on redemption restrictions (like the MBR), those that prevent shareholders from redeeming all of their cash, also are not the right answer.

Our customers have told us – loudly and clearly – that they have little or no interest in a product with a floating NAV or one that continually limits access to their funds.

Why would such drastic changes to the core features that investors value in the money market mutual fund product be necessary or helpful?

For instance, why would an Institutional Prime Money Market Mutual Funds that today is required to maintain significant weekly liquidity ... indeed, more liquidity than the historical worst-case outflows – why would these funds need redemption restrictions in the ordinary course of business?

If the SEC concludes that Institutional Prime Money Market Mutual Funds need further reform, a better approach would be requiring liquidity gates and/or fees that would be triggered only during times of market stress.

Under this model, if a fund's weekly liquid assets fell below a certain threshold, the fund would institute a temporary restriction that automatically would suspend redemptions for a period of time to allow the fund to restore its health.

If the fund's weekly liquidity level continued to fall to a level below another predetermined threshold, shareholders would have the option to redeem, subject to a fixed redemption fee of 1%.

Imposing a redemption fee would compensate the fund and its remaining shareholders for the costs of withdrawing liquidity from the fund.

We believe that halting redemptions or charging a fee when liquidity is scarce is the only effective means of stopping large, sudden outflows. This would be a far more effective means of addressing a clearly defined issue within one specific segment of the money market mutual fund product.
Closing

In closing, neither the SEC nor the FSOC has demonstrated the need for any additional regulation of Treasury, Government, Muni or Retail Prime funds. These funds are not susceptible to runs, they present negligible credit risk, and they have massive liquidity.

Fundamentally changing the core characteristics of money market mutual funds would jeopardize the viability of this crucial cash management product and drive investors to products that may be less-regulated, less transparent or less stable, with adverse consequences for the stability of the financial system.

The result, we are convinced, would be restricted access to credit, increased borrowing costs, and significant harm to the overall economy.

We urge the SEC to carefully tailor any further reforms.

Taking a broad-brush approach by imposing further regulations on all types of money market mutual funds, regardless of their risk profile, would be contrary to the SEC's mandate ... to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation.

If more reform is needed, it should be limited to Institutional Prime Funds and be narrowly tailored to address the risk in this specific segment of the industry as highlighted by the SEC study.
Before investing, consider the funds' investment objectives, risks, charges, and expenses. Contact your investment professional or visit advisor.fidelity.com for a prospectus or, if available, a summary prospectus containing this information. Read it carefully.


Views expressed are as of February 2013, and may change based on market and other conditions.

Past performance is not a guarantee of future results. Current and future portfolio holdings are subject to risk.

An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund.

As with all of your investments, you must make your own determination whether an investment in any particular security or fund is consistent with your investment objectives, risk tolerance, financial situation, and your evaluation of the investment option. Fidelity is not recommending or endorsing any particular investment option by mentioning it in this presentation or by making it available to its customers. This information is provided for educational purposes only, and you should bear in mind that laws of a particular state and your particular situation may affect this information. There is no guarantee the trends discussed here will continue. Investment decisions should take into account the unique circumstances of the individual investor.

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