I. SEC's New Money Market Rules

A. Introduction

The Securities and Exchange Commission (SEC) enacted new rules to regulate money market funds (MMFs) on October 14, 2016.[1] MMFs are short-term, liquid assets that have historically maintained a steady $1.00 net asset value (NAV) per share[2] (a measure of a "company's total assets minus its total liabilities"[3]). During the financial crisis of 2008, a large MMF called the Reserve Primary Fund's NAV fell below $1.00 and was forced to liquidate.[4] This sparked a run on MMFs.[5] The U.S. Treasury intervened to guarantee that the shares of MMFs would remain at a $1.00 NAV.[6] The goal of the new SEC rules is to prevent future runs on MMFs.[7] These reforms include instituting a floating NAV on "prime" MMFs, which are MMFs invested in corporate debt.[8] The reforms also impose fees and redemption gates, which temporarily prohibit investors from withdrawing their investments in MMFs.[9] While some reforms have received praise for increasing the safety of MMF markets, reforms such as the fees and redemption gates have sparked controversy.[10] In

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[1] Vipal Monga & Heather Gillers, *New Rules and Fresh Headaches for Short-Term Borrowers*, WALL ST. J. (Aug. 25, 2015), http://www.wsj.com/articles/new-rules-and-fresh-headaches-for-short-term-borrowers-1470695795 [https://perma.cc/H8TZ-RDXU].

[2] Samuel G. Hanson et al., *An Evaluation of Money Market Fund Reform Proposals*, IMF 1, 3 (2014), https://www.imf.org/external/np/seminars/eng/2013/mmi/pdf/Scharfstein-Hanson-Sunderam.pdf [https://perma.cc/U5BM-X5K2].

[3] *Net Asset Value*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/answers/nav.htm [https://perma.cc/L5JW-JPA5].

[4] PRESIDENT'S WORKING GRP. ON FIN. MARKETS, MONEY MARKET FUND REFORM OPTIONS 1, 12 (2010) [hereinafter PRESIDENT'S WORKING GRP.].

[5] *Id.*

[6] *Id.* at 12–13.

[7] Press Release, Sec. & Exch. Comm'n, SEC Adopts Money Mkt. Fund Reform Rules (July 23, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679 [https://perma.cc/LC6J-CLVY].

[8] *Id.*

[9] *Id.*

[9] *Id.*

[10] *See* Letter from Eric Rosengren, President and CEO, Fed. Reserve Bank of Bos., to Elizabeth M. Murphy, U.S. Sec. and Exch. Comm'n (Sept. 12, 2013),

response to the rules, many MMFs have transitioned to holding assets in government securities, so their MMFs will not be subject to a floating NAV, fees, or gates.[11]

First, Section B provides a background on MMFs. Section C discusses the run on MMFs during the financial crisis of 2008, the inherent risks of MMFs, and the SEC's initial reforms to MMFs in 2010. Section D states the SEC's new rules and reactions to the rules from the presidents of the twelve regional Federal Reserve banks and prominent economists, among others. Section E provides alternative rules for MMFs suggested by the Financial Stability Oversight Council. Lastly, Section F explains how MMF managers have responded to the rules and consequences of the rules.

B. Background on Money Market Funds

"Money market funds are a type of mutual fund developed in the 1970s as an option for investors to purchase a pool of securities that generally provided higher returns than interest-bearing bank accounts."[12] MMFs invest in "high-quality, short-term debt securities" such as "government securities, tax-exempt municipal securities, or corporate debt securities."[13] MMFs are an important source of funding for financial institutions because MMFs buy securities, such as commercial paper, certificates of deposit, and repos, which are issued by banks.[14] The funds are most popular among institutional investors, who own around two-thirds of all MMFs.[15] As of October 12, 2016, more than $2.6 trillion is invested in MMFs.[16]

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http://www.bostonfed.org/-/media/Documents/Press Releases/PDF/pr091213-letter.pdf [https://perma.cc/U7CU-S2R8] [hereinafter FRB Letter].

[11] *See, e.g.*, *Money market reform: What you need to know*, VANGUARD GROUP, INC., https://investor.vanguard.com/mutual-funds/money-market-reform/#/layer8 [https://perma.cc/ELS8-TDJ7] (follow "Read the transcript" hyperlink); *Update on money market fund regulations*, FIDELITY (Oct. 1, 2016), https://www.fidelity.com/viewpoints/investing-ideas/money-market-update [https://perma.cc/NZ34-G8DX].

[12] *Reforming Money Market Funds*, U.S. SEC. & EXCH. COMM'N (June 5, 2013), https://www.sec.gov/News/Article/Detail/Article/1365171576956 [https://perma.cc/EJ76-SFNU].

[13] *Id.*

[14] *Id.* at 4–5.

[15] PRESIDENT'S WORKING GRP., *supra* note 4, at 8.

[16] INV. CO. INST., *Money Market Fund Assets* (Oct. 13, 2016), https://www.ici.org/research/stats/mmf [https://perma.cc/D447-UQL3].

The SEC regulates MMFs under Rule 2a-7 of the Investment Company Act of 1940.[17] In the past, Rule 2a-7 allowed MMFs to maintain a steady $1.00 NAV by using an amortized cost method of accounting to calculate the values of securities within MMFs.[18] Securities in MMFs are usually sold at a discount to their face value ("dollar value of a security stated by the issuer").[19] Using the amortized cost method of accounting, fund managers assume that these securities rise in value by the same increments each day, until they reach their face value.[20] The fund managers use these amortized cost estimates to compile a fund with a NAV of $1.00.[21] Under Rule 2a-7, fund managers must compare the amortized cost values of MMF securities to their market values to examine if the market values have fallen $0.005 below $1.00.[22] Fund managers must decrease the NAV of MMFs whose market values have fallen below $1.00, which is called "breaking the buck."[23] The stability of a $1.00 NAV distinguishes MMFs from other funds.[24]

In the past, MMFs have also allowed investors to withdraw funds on demand.[25] For individual investors, MMFs may resemble deposit accounts,[26] as they offer many transactional services and are considered to be low-risk assets in which to place money.[27] However,

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[17] Hanson et al., *supra* note 2, at 3.
[18] PRESIDENT'S WORKING GRP., *supra* note 4, at 7.
[19] *Face Value*, INVESTOPEDIA, http://www.investopedia.com/terms/f/facevalue.asp [https://perma.cc/B4CS-DRC4]; INV. CO. INST., *Pricing of U.S. Money Market Funds* 1, 8 (Jan. 2011), https://www.ici.org/pdf/ppr_11_mmf_pricing.pdf [https://perma.cc/P7WV-JNVR].
[20] *See* INV. CO. INST., *Pricing of U.S. Money Market Funds* 1, 8 (Jan. 2011), https://www.ici.org/pdf/ppr_11_mmf_pricing.pdf [https://perma.cc/P7WV-JNVR] (using an example of a security bought at a discounted price of $99.40 that will return a face value of $100 in sixty days, rising in value by one cent each day, to demonstrate amortized cost accounting).
[21] *See id.* (describing how the use of amortized cost values are incorporated into the value of MMFs).
[22] PRESIDENT'S WORKING GRP., *supra* note 5, at 7.
[23] *Id.*
[24] *Id.* at 8.
[25] *Id.*
[26] Hanson et al., *supra* note 2.
[27] PRESIDENT'S WORKING GRP., *supra* note 4, at 8 ("MMFs compete with other stable-value, low-risk investments. Because MMFs generally maintain stable NAVs, offer redemptions on demand, and often provide services that compete with those offered to holders of insured deposits (such as

in contrast to deposit accounts, MMFs are not covered by Federal Deposit Insurance Corporation's (FDIC).[28]

C. Need for Money Market Reform Proposals

On September 16, 2008, the NAV of the Reserve Primary Fund, a large money market fund that held $62 billion in assets, dropped to $0.97 per share, "breaking the buck."[29] The fund had $785 million of exposure to Lehman Brother's commercial paper, which lost its value when Lehman filed for bankruptcy.[30] Within two days of Lehman Brother's bankruptcy, MMF investors withdrew nearly $40 billion.[31] The fund began selling off its assets to meet investors' redemptions, but was eventually forced to liquidate.[32] Investors also withdrew approximately $310 billion in one week from similar MMFs, which held financial sector debt.[33] MMFs were reluctant to invest in short-term debt issued by banks, and so banks and other corporations lacked access to much-needed short-term credit.[34] Other funds were able to maintain the $1.00 NAV because companies provided financial support to their MMFs.[35] On September 19, 2008, the U.S. Treasury announced the Temporary Guaranteed Program to insure MMF assets to maintain the $1.00 NAV, which quelled the run on MMFs.[36]

Inherently, the structure of MMFs makes them susceptible to runs.[37] In times of stress, MMF fund managers first sell liquid assets such as government securities to try to maintain the face value of bonds.[38] If that does not stabilize the value, fund managers sell illiquid assets, often at a heavy discount, triggering a further decline in the

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transactions services), many retail customers likely consider MMF shares and bank deposits as near substitutes . . . .").

[28] Hanson et al., *supra* note 2, at 3.

[29] PRESIDENT'S WORKING GRP., *supra* note 4, at 12.

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Id.*

[34] *Id.* at 8.

[35] *Id.* at 12 ("[M]any MMF sponsors provided substantial financial support to prevent capital losses in their funds.").

[36] *Id.* at 12–13.

[37] Hanson et al., *supra* note 2, at 8–9.

[38] *Id.* at 10 ("This creates run risk because early investor redemptions can be met with the sale of liquid Treasury bills, which generate enough cash to fully pay early redeemers.").

value of the MMF.[39] This may trigger a run on the MMFs as investors try to sell their shares in order to recoup the face value of their MMFs, given that the early sellers are likely to get the full value of their shares.[40] In general, highly-risk averse investors place their money in MMFs because MMFs are considered to be very safe assets, so when the value of the MMFs drops even slightly, these investors tend to panic and withdraw their money, fearing further volatility.[41] Investors assume that negative influences on a failing fund are likely to affect others as well; therefore, a run on a single MMF can have a ripple effect, potentially triggering a run on the entire MMF market.[42] This run on assets reduces bank funding.[43] The stable $1.00 NAV of MMFs is susceptible to risks of low interest rates and downgrades in the credit ratings of securities in which MMFs invest.[44] Historically, MMFs have been able to maintain a $1.00 NAV in spite of these risks, because fund managers pour money into the funds in times of volatility.[45] But, MMFs' dependence on sponsors to provide funding can expose MMFs to the risks of sponsor firms.[46] Economists theorize that insuring MMFs during the 2008 financial crisis created a "moral hazard problem," because market participants now expect that the government will insure MMFs in the future in cases of major risk.[47]

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[39] *Id.* at 9.
[40] *Id.*
[41] PRESIDENT'S WORKING GRP., *supra* note 4, at 3.
[42] Hanson et al., *supra* note 2, at 10.
[43] *Id.*
[44] PRESIDENT'S WORKING GRP., *supra* note 4, at 9.
[45] *Id.* at 9–10.
[46] *See id.* (finding that MMFs with sponsor firms that were doing poorly in the 2008 financial crisis were more likely to fail than peers with stronger sponsor firms).
[47] Neil Irwin, *The Hidden Cost of Bailouts: The Money Market Mutual Funds and Moral Hazard*, WASH. POST (Sept. 28, 2012), https://www.washingtonpost.com/business/economy/the-hidden-cost-of-bailouts-the-money-market-mutual-funds-and-moral-hazard/2012/09/28/e178cc1c-0966-11e2-858a-5311df86ab04_story.html [https://perma.cc/R5AE-RZR9] ("The Treasury . . . deployed a massive bailout to keep investors in money-market mutual funds from losing their shirts. It succeeded. But the very fact of that success has meant there is little sense of urgency around changing the way the funds are regulated to try to keep them from putting the economy at risk again. Economists call it moral hazard.").

In 2010, the SEC implemented rules to reduce the likelihood of runs and increase stability of funds.[48] A significant part of the 2010 rules was that MMFs must maintain 10 percent of their assets as daily assets, which can be converted into cash daily, and 30 percent of their assets as weekly liquidity assets, which can be converted into cash weekly.[49] If investors simultaneously try to redeem their money, MMFs will be better able to maintain a $1.00 NAV because they are less likely to have to sell assets at discounted prices.[50] Although the 2010 SEC rules address some risks, MMFs require significant reforms to prevent runs in the future.[51]

D. New SEC Rules

On July 23, 2014, the SEC announced new rules intended to "reduce the risk of runs in money market funds and provide important new tools that will help further protect investors and the financial system."[52] The SEC granted a two-year period for implementation of the rules and the rules officially took effect on October 14, 2016.[53] The new rules subject institutional prime funds to a floating NAV, enable MMF managers to stop withdrawals from MMFs, and enhance MMF disclosure requirements.[54]

1. Floating NAV

The new rules mandate that all institutional prime money market funds must have a floating NAV.[55] The effect of a floating NAV is that the values of MMF shares reflect daily prices of the securities within their portfolios, instead of a $1.00 stable share price.[56]

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[48] PRESIDENT'S WORKING GRP., *supra* note 4, at 14.
[49] *Id.*
[50] *Id.*
[51] *See id.* at 16.
[52] Press Release, U.S. Sec. and Exch. Comm'n, SEC Adopts Money Mkt. Fund Reform Rules (July 23, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679 [https://perma.cc/LC6J-CLVY].
[53] Monga & Gillers, *supra* note 1.
[54] Press Release, U.S. Sec. and Exch. Comm'n, SEC Adopts Money Mkt. Fund Reform Rules (July 23, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679 [https://perma.cc/LC6J-CLVY].
[55] *Id.*
[56] *Id.*

The SEC's new rules distinguish between institutional prime, government, and retail funds. Institutional prime funds are defined as "market funds that primarily invest in corporate debt securities."[57] The rules define government funds as "any money market fund that invests 99.5 percent (formerly 80 percent) or more of its total assets in cash, government securities and/or repurchase agreements that are collateralized solely by government securities or cash."[58] A retail fund is defined as "a money market fund that has policies and procedures reasonably designed to limit all beneficial owners of the money market fund to natural persons."[59] Government and retail funds are allowed to maintain a fixed $1.00 NAV, rounding to the nearest penny.[60] Prime MMFs will not be able to show share prices to the nearest penny as they have done for decades, and now must show prices to four decimal places.[61] Further, prime MMFs will no longer be able to use an amortized cost method of accounting to estimate MMF NAVs.[62]

The rules do not apply to government funds likely because 90 percent of withdrawals were from prime funds in the 2008 financial crisis, showing that government funds are not susceptible to runs.[63] Similarly, the rules do not apply to retail funds likely because investors were less susceptible to runs in the 2008 financial crisis.[64]

The goal of these new rules is to expose investors to the daily risks of the securities within the MMF.[65] This policy emphasizes that the investors bear the risk of fluctuations in the value of the fund, rather than the company that offered the fund or the government.[66] The

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[57] *Id.*
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] *Id.* ("Currently, money market funds 'penny round' their share prices to the nearest one percent (to the nearest penny in the case of a fund with a $1.00 share price). Under the floating NAV amendments, institutional prime money market funds instead would be required to 'basis point round' their share price to the nearest 1/100th of one percent (the fourth decimal place in the case of a fund with a $1.00 share price.").
[62] *Id.*
[63] *See* PRESIDENT'S WORKING GRP., *supra* note 4, at 30 (finding that institutional prime funds experienced the greatest outflows).
[64] *Reforming Money Market Funds*, U.S. SEC. & EXCH. COMM'N (June 5, 2013), https://www.sec.gov/News/Article/Detail/Article/1365171576956 [https://perma.cc/EJ76-SFNU].
[65] *Id.*
[66] *Id.*

rule also reduces investors' incentive to be the first to withdraw their investments from MMFs when they anticipate the MMF's value to fall below $1.00, a behavior that would otherwise precipitate runs on MMFs.[67]

The presidents of the twelve Federal Reserve banks (FRB Presidents) signed a letter supporting the floating NAV requirement, but suggesting qualifications and improvements.[68] They agree that a floating NAV removes the "first mover advantage" to draw money out of the MMFs when investors anticipate falling MMF prices[69] and places the onus of absorbing price movements on the investor.[70] However, the FRB Presidents argue that calculating the floating value of the securities in MMFs is difficult because they are not traded frequently.[71] They hypothesize that a combination of market pricing and valuation models to estimate the prices of securities will be sufficient and propose that the SEC should monitor firms' valuation policies.[72] Finally, the FRB Presidents believe that retail investors should be subject to the new rules.[73] Although investors did not pull their money from retail funds during the financial crisis of 2008, the SEC cannot assume that investors will idly keep their money in retail MMFs in subsequent periods of financial volatility.[74]

Others have noted that the floating NAV is unlikely to change anything because the floating NAVs are unlikely to be different than the stable $1.00 NAV.[75] In times of stress, investors retain the

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[67] *Id.*

[68] FRB Letter, *supra* note 10.

[69] *Id.*

[70] *Id.* ("We agree with the SEC's position that a floating NAV requirement, if properly implemented, could recalibrate investors' perceptions of the risks inherent in a fund by "making gains and losses a more regularly observable occurrence.").

[71] *See id.* ("One often-mentioned challenge to valuing non-government related money market instruments is the infrequency of secondary market transactions for such instruments.").

[72] *See id.* ("While the resulting prices may serve as a natural starting point for market-based NAV computations required under this alternative, we encourage the SEC to continue its efforts to increase the transparency of fixed income markets to further enhance price discovery.").

[73] *Id.*

[74] *Id.*

[75] Hanson et al., *supra* note 2, at 4 ("[B]ecause the paper held by MMFs is illiquid, moving to a floating NAV product is unlikely to produce significant

incentive to divest from MMFs with the expectation that the fund will be forced to sell its illiquid assets at a sharp discount in order to maintain its value.[76]

2. Liquidity Fees and Gates

The SEC's new rules allow MMF Boards to impose fees and redemption gates.[77] The SEC's rules stipulate that MMF Boards can impose "fee[s] of up to two percent on all redemptions" "if a money market fund's level of 'weekly liquid assets' falls below 30 percent of its total assets (the regulatory minimum) . . . ."[78] In addition, "[i]f a money market fund's level of weekly liquid assets falls below 10 percent, the money market fund would be required to impose a liquidity fee of one percent on all redemptions."[79] "Weekly liquid assets generally include cash, U.S. Treasury securities, certain other government securities with remaining maturities of 60 days or less, and securities that convert into cash within one week."[80] It should be noted however, that the Board has discretion over whether or not to impose a fee, as well as whether to increase or decrease the fee amount (within 2 percent), based on what is best for a particular fund.[81] The rules allow MMF Boards to "temporarily suspend redemptions (gate)" "if a money market fund's level of weekly liquid assets falls below 30 percent . . . ."[82] Impositions of gates are similarly subject to Boards' discretion.[83] "A money market fund that imposes a gate would be required to lift that gate within 10 business days, although the board of directors could determine to lift the gate earlier."[84] MMF Boards must disclose to investors if weekly liquid assets fall below 10 percent, or if

variation in reported NAVs—floating NAV MMFs would probably look very similar to today's stable NAV product.").

[76] *Id.* at 3.

[77] Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Money Mkt. Fund Reform Rules (July 23, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679 [https://perma.cc/LC6J-CLVY].

[78] *Id.*

[79] *Id.*

[80] *Id.*

[81] *Id.*

[82] *Id.*

[83] *Id.* ("To impose a gate, the board of directors would find that imposing a gate is in the money market fund's best interests.").

[84] *Id.*

the Board imposes or lifts a liquidity fee or gate.[85] However, government MMFs are not subject to the rules on fees or gates.[86]

In their letter to the SEC discussing the proposed MMF rules, the FRB Presidents noted that allowing the imposition of fees or gates would likely trigger a run on assets before the gate was imposed.[87] These rules do not diminish the inherent risks of funds.[88] They argued that because funds are relatively homogenous, fees or gates imposed on one fund could spark large withdrawals from all other funds.[89] Investors rely on the liquidity of MMFs for cash management and to gain returns, but imposing fees or gates eliminates this crucial feature MMFs.[90] Finally, Rule 2a-7 has always allowed for the imposition of gates when MMFs break the buck, but this rule has not prevented runs; so, some argue these new rules are not likely to prevent runs either.[91]

3. Other Rules

Under the newly effective rules, MMFs must make several disclosures on their websites, including daily and weekly liquid assets, market-based NAVs per share, whether the Board has levied fees or gates, and whether the fund has received support from affiliates.[92]

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[85] *Id.*
[86] *Id.* ("However, under the proposed rules, these funds could voluntarily opt into them, if previously disclosed to investors.").
[87] FRB Letter, *supra* note 10 ("Because investors are unable to predict how other investors would react once a fund's weekly liquid asset level begins to deteriorate, their safest option may be to run in advance of the fund breaching the trigger.").
[88] *Id.* ("Stand-by liquidity fees and temporary redemption gates do not meaningfully address the risks to financial stability posed by [MMFs].").
[89] *Id.*
[90] *Id.*
[91] Hanson et al., *supra* note 2, at 27–28 ("Rule 2a-7 already contains a gating rule, which has proven to be ineffective. In particular, the fund may suspend redemptions if its NAV falls below $0.995—i.e., if a fund "breaks the buck". This rule incentivizes investors to redeem their shares at the first indication of trouble out of fear that their cash could be trapped in the fund if it suspends redemptions. New gating rules will simply exacerbate the incentives for investors to redeem early by setting a threshold for redemption fees or restrictions closer to $1.00 than the existing threshold of $0.995.").
[92] Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Money Mkt. Fund Reform Rules (July 23, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679 [https://perma.cc/LC6J-CLVY].

Moreover, MMFs must disclose instances in the last ten years when they received support from an affiliate or sponsor.[93] Finally, the MMF Board must disclose the reasons for, among other things, the imposition of fees or gates, the need for sponsor or affiliate support, and the drop in fund value below $0.9975.[94] These proposals have received strong support from the FRB Presidents because they quell investors' concerns that their MMF investments are exposed to assets plummeting in value.[95]

In addition to a floating NAV, liquidity fees and gates, and enhanced disclosure requirements, the SEC adopted rules enhancing stress testing, strengthening diversification requirements, and strengthening methods of determining MMF credit quality.[96] Among other proposals to improve reporting, the SEC will amend the Form PF disclosure used by private fund advisers to track "whether substantial assets migrate to private 'liquidity funds' in response to money market fund reforms."[97]

E. Alternatives Rules

In 2012, the Financial Stability Oversight Council (FSOC), recommended that the SEC pass structural reforms for MMFs.[98] Specifically, FSOC suggested the following reforms:

> [R]equiring MMFs to float reported net asset values (NAVs) (Alternative 1); requiring MMFs to have a 1% capital buffer combined with a "Minimum Balance at Risk" (MBR) provision whereby investors cannot immediately redeem all of their shares (Alternative 2); or requiring MMFs to have a 3% subordinated capital buffer (Alternative 3).[99]

A study performed by three Harvard economists suggested Alternative

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[93] *Id.*
[94] *Id.*
[95] FRB Letter, *supra* note 10.
[96] Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Money Mkt. Fund Reform Rules (July 23, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679 [https://perma.cc/LC6J-CLVY].
[97] *Id.*
[98] Hanson et al., *supra* note 2, at 1.
[99] *Id.*

3 was the only proposal that would truly reduce the risk of MMFs.[100] The study found that a 3–4 percent capital buffer would help prevent runs on assets in a well-diversified portfolio.[101] In their report, the economists who conducted the study suggest that the SEC should require higher capital buffers for more concentrated funds.[102] They estimated that investors would see a reduction in yield of 0.05 percent on MMF dividends in normal periods for this increased capital buffer.[103] If the MMF values drop significantly, these minimum balances absorb losses first.[104]

Commentators argue that a floating NAV will remove an essential and attractive attribute of MMFs and will do little to promote financial stability.[105] Instead, they argue that regulators should focus on regulating banks and should "narrowly tailor" MMF reforms to create liquidity procedures during times of stress.[106]

F. Industry Reactions to the New Rules

Some investment management firms have informed their clients that the SEC's new rules will change little in their portfolios.[107] This is largely because companies such as Fidelity and Vanguard will transition their prime funds into government funds, so their customers will not be subject to floating asset values or fees and gates.[108] In fact, the Investment Company Institute has tracked the flows of over a quarter of a billion dollars from prime MMFs to government funds in

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[100] *Id.* at 2.
[101] *Id.*
[102] *Id.*
[103] *Id.*
[104] *Id.*
[105] Jill Fisch & Eric Roiter, *A Floating NAV for Money Market Funds: Fix or Fantasy?*, 2012 U. ILL. L. REV. 1003, 1049–50 (2012).
[106] *Id.* at 1050.
[107] *See, e.g.*, *Money market reform: What you need to know*, VANGUARD, https://investor.vanguard.com/mutual-funds/money-market-reform/#/layer8 [https://perma.cc/ELS8-TDJ7] (follow "Read the transcript" hyperlink) ("Justin Schwartz: I think the most important thing to note is that for most of our shareholders, not a lot is going to change").
[108] *Id.*; *Update on money market fund regulations*, FIDELITY (Oct. 1, 2016), https://www.fidelity.com/viewpoints/investing-ideas/money-market-update [https://perma.cc/NZ34-G8DX].

the few months before the rule was enacted.[109] Other investors have argued that these rules are onerous because investors depend on the stable NAVs of MMFs for cash management and some owners of MMFs may no longer see MMFs as a viable investment.[110] Investment managers such as Vanguard have expanded offerings of short-term bonds to use in lieu of MMFs.[111]

The new MMF rules impose higher borrowing costs for banks and other institutions in which MMFs invest, evident in the recent increase of the London interbank offered rate (LIBOR), which represents the cost of borrowing for banks, among others.[112] This increase in borrowing cost is due to the fact that banks received an estimated 35 percent of their funding from MMFs purchasing their short-term loans, and this funding is likely to decline.[113] Nevertheless, "[t]he SEC has said it had anticipated increases in borrowing rates when it passed the rule in 2014, but felt the trade-off was worth it to avoid a repeat of 2008."[114]

Finally, the SEC hypothesizes that investments from MMFs may move to private liquidity funds.[115] Similar to MMFs, private liquidity funds invest in short-term debt obligations and try to maintain a steady NAV.[116] But, because they are only open to "accredited

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[109] Monga & Gillers, *supra* note 1 ("Assets held by prime money-market funds dropped below $1 trillion at the end of July for the first time in 17 years and have fallen by more than a quarter of a trillion dollars since mid-March, according to the Investment Company Institute.")

[110] *Id.* ("Corporate treasurers that invest in money-market funds and others who can't afford the risk of losing access to their money find the rules burdensome").

[111] *Money market reform: What you need to know*, *supra* note 107 (finding that Vanguard will now offer short-term funds that offer a higher yield than government MMFs but have a similar risk profile to prime MMFs)

[112] Monga & Gillers, *supra* note 1.

[113] Hanson et al., supra note 2, at 5.

[114] Monga & Gillers, *supra* note 1.

[115] Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Money Mkt. Fund Reform Rules (July 23, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679 [https://perma.cc/LC6J-CLVY] ("To better monitor whether substantial assets migrate to private 'liquidity funds' in response to money market fund reforms, the final rules would amend Form PF, which private fund advisers use to report information about certain private funds they advise.").

[116] *See* David C. Johnson, *Private Fund Data Shed Light on Liquidity Funds*, OFFICE OF FIN. RESEARCH 1 (July 9, 2015), https://www.financialresearch.

investors" and are exempt from regulation of the Investment Company Act of 1940, private liquidity funds often invest in riskier assets with more concentrated risk[117] and are similarly susceptible to runs.[118] Over the next few years, FSOC will evaluate the sufficiency of the SEC's reforms and suggest additional steps accordingly.[119]

G. Conclusion

The SEC rules have changed the fundamental characteristics of a MMF, so that investors now bear more risk and are more aware of daily changes rather than seeing a $1 NAV.[120] Although many argue that these rules have not reduced the inherent risks of the MMFs, they have exposed investors to the risks of MMFs.[121] There is clearly more emphasis on regulation of MMFs after the financial crisis, and whether the risk of runs has been reduced or displaced to another instrument, the FSOC and SEC will work together to continue to monitor the rules' impact and make additional rules at their discretion.[122]

Kuhu Parasrampuria[123]

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gov/briefs/files/OFRbr-2015-05-Private-Fund-Data-Shed-Light-on-Liquidity-Funds.pdf [https://perma.cc/924H-N9QZ].
117 *Id.*
118 *Id.* at 7.
119 Anthony Conte et al., *Ten key points from the SEC's final money market rule,* PwC (July 24, 2014), http://www.pwc.com/us/en/financial-services/regulatory-services/publications/assets/first-take-secs-money-market-reform.pdf [https://perma.cc/HG24-L9X7] (determining that the FSOC has authority to evaluate the SEC's reforms and offer feedback).
120 Monga & Gillers, *supra* note 1 (noting that some investors may no longer find MMFs a viable investment because they have lost their attractive features).
121 FRB Letter, *supra* note 10.
122 Conte et al., *supra* note 119.
123 Student, Boston University School of Law (J.D. 2018).