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The Regulation of U.S. Money Market Funds: Lessons from Europe

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The recent financial crisis challenged long held perceptions of money market funds (MMF) as stable and highly liquid instruments. Regulators in the United States and in Europe now seek to impose additional rules on MMFs to buttress the funds’ ability to sustain runs. In the United States, the debate is drawing even more media attention as the question of which regulatory body should lead the way—the Securities and Exchange Commission, the Treasury Department, or the Financial Stability Oversight Council—has taken interesting twists and turns. This article examines primary reform options being proposed in the United States, and concludes that additional rules that were implemented by the SEC in 2010 have adequately strengthened the perceived weaknesses of the MMF industry, which has for the most part proven itself reliable. If, after further in depth study and analysis, regulators conclude that additional regulations are advisable, the proposal of a capital buffer is the most promising reform option. The paper’s ultimate conclusion is informed by the experiences of the European fund industry which, provide invaluable lessons for U.S. regulators on what reform options are viable.
I. INTRODUCTION

On that fateful day in 2008, when the Reserve Primary Fund announced that it would be “breaking the buck” there was sheer panic.1 In just a few days, more than 309 billion USD was withdrawn from funds, thereby dislocating commercial paper and freezing the credit markets.2 The U.S. government had to step in to create liquidity facilities and extend deposit guarantees.3 This unexpected and very rare occurrence was a huge blow to the U.S. money market fund (MMF) industry, since fund managers have always prided themselves on keeping net asset value (NAV) at a constant dollar per share. The U.S. funds, nonetheless, were not the only ones to succumb to the recent financial meltdown. Across the Atlantic, European MMFs did not escape the devastating consequences of the U.S. sub-prime mortgage crisis.4 In fact, many European funds had to be supported by sponsor banks or be suspended.5 The difference, however, was that European MMFs fared much better than the U.S. funds and did not require the guarantees of European government officials.6

It has been approximately four years since this financial meltdown, and since then, MMFs have been operating in an atmosphere of regulatory uncertainty. Despite the set of extensive regulations passed in the recent years, regulators in both the United States and Europe have indicated that additional reform is essential. In the United States, the Securities and Exchange Commission (SEC) and the U.S. Department of the Treasury (Treasury) have been the main bodies stimulating the discussion. But recently, the SEC’s Chairman stated that the SEC will step away from the issue, making room for the Financial Stability Oversight Council (FSOC) to carry on the baton.7 In Europe, among the

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2 Money Market Fund Reform, Investment Company Act Release No. IC-29132, 75 Fed. Reg. 10060, 10061 (Mar. 4, 2010) (codified at 17 C.F.R. pt. 270, 274) [hereinafter Release No. 29132], (“During the week of September 15, 2008, investors withdrew approximately $300 billion from prime money market funds, or 14 percent of the assets held in those funds. In the final two weeks of September 2008, money market funds reduced their holdings of top-rated commercial paper by $200.3 billion, or 29 percent.” (footnote omitted)).
3 Id.
5 Id.
6 Id.
different regulatory bodies discussing the issue is the European Securities and Markets Authority (ESMA)—the regulatory body that oversees securities trading—and the Institutional Money Market Fund Association (IMMFA). 8

Four years and numerous reports later, however, there is no consensus on what additional rules should be imposed on the MMF sector.9 More importantly, in the United States, which is the primary focus of this paper, many argue that the 2010 amendments to rules governing MMFs are sufficient to strengthen the funds and that further regulation will hurt rather than help.10 As a general proposition, this paper agrees with the position that extensive, additional regulation is likely to result in MMF investors moving their capital to other unregulated, riskier sectors. Ultimately, this paper’s conclusion on the best way forward is informed by the experiences of the European funds. There are important lessons that can be learned by comparing the two regimes. First, however, this paper will examine the utility of MMFs and their basic characteristics. Second, this paper will focus on U.S. funds, the regulatory framework they have been subject to since their inception, and the changes in regulations that were inspired by the financial crisis. This paper will then examine European MMFs and additional rules that were imposed on those instruments in response to the economic events of 2007–2008. This section will also highlight critical similarities and differences between MMF regulations under the two regimes. And finally, this paper will discuss whether additional regulation is needed and explore the main reform options being proposed.

This paper concludes that recent changes in the regulatory environment in which MMFs operate are adequate to strengthen the funds’ ability to sustain runs and lessen their systemic risks. Furthermore, where reform initiatives are shaping to fit the model of what Professor Roberta Romano calls “quack governance,” regulators should proceed with caution and discuss the issues ad nauseum before making any changes to the current regulatory framework.11

Acknowledging that there is always room for improvement, this paper posits that reform options that do not effectively change the model under which MMFs have been successfully operating for years may be

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10 See, e.g., Gallagher & Paredes Statement, supra note 9.

considered. Of this category, the most beneficial and cost effective is the proposal of a mandatory capital buffer.12

II. MONEY MARKET FUNDS AND THE FINANCIAL CRISIS

A. Money Market Funds Generally

MMFs are a type of mutual fund.13 They pool investors’ capital to purchase low-risk, highly liquid securities with short maturity periods.14 Hence, the funds typically invest in Treasury bills, certificates of deposit, commercial paper, and repurchase agreements.15 Often, MMFs are likened to bank deposit accounts because they serve as a medium of exchange while perceivably offering protection of principal.16 Nonetheless, the two instruments are markedly different. Like most investment vehicles in the capital markets, MMFs are not obligated to pay their shareholders in full the way a bank has an unconditional obligation to its depositors.17 Fulfilling rigorous standards governing investment portfolios is a contingency for returning a stable dollar per share to shareholders.18 And, there is no legal obligation for a fund's sponsor to support its fund.19 Therefore, as the events of 2008 have revealed, in rare cases a MMF does drop its target price below a dollar, which is colloquially known as “breaking the buck.”20

The maintenance of a fixed NAV is, however, the main distinguishing feature of MMFs when compared to other mutual funds.21 But not all MMFs are created equally; some variable net asset value (VNAV) funds do not have a stable face value of a dollar per share.22 The primary difference between VNAV funds and constant net asset value (CNAV) funds lies in the type of accounting method used to value the assets.23 CNAV funds, the only type found in the United States, uses amortized

15 See Release No. 29132, supra note 2; Money Market Funds, supra note 13.
18 Id.
19 Id.
22 Id.
23 Id.
cost accounting. Rather than using market rates to value assets, the amortized cost approach values securities at acquisition cost “as adjusted for amortization of premium or accretion of discount rather than at their value based on current market factors.” These funds are therefore able to maintain a stable NAV by declaring these accruals as daily dividends to its shareholders.

In the United States, a CNAV fund may also use an accounting procedure called “penny rounding.” This method is not used in Europe, and it is not clear whether any of the U.S. funds currently use this method of valuation. VNAV funds, on the other hand, use mark-to-market accounting. Simply put, these funds value assets at market price. As a result, their NAV “will vary by a slight amount due to the changing value of assets and, in the case of an accumulating fund, by the amount of income received.” Europe has both CNAV and VNAV funds. The VNAV model does not exist in the United States. From a financial stability perspective, VNAV funds are considered to be less risky than CNAV funds.

As a general matter, MMFs represent a significant share of the global funds industry, with the United States and Europe accounting for 90% of that share. For the second quarter of 2012 MMFs worldwide assets represented an impressive $24.77 trillion USD.

**Worldwide Mutual Fund Assets**

*Trillions of U.S. dollars, end of quarter*

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In addition, the fund industry is very intertwined with the global financial system. The primary example of this is the fact that U.S. funds invest heavily in European banks. Consequently, a disruption in the U.S. fund industry has immobilizing consequences for banks and businesses in Europe that rely on this short term funding.35

B. Regulatory Framework of MMFs in the United States and the Financial Crisis

1. History of MMFs in the United States and Pre-Crisis Regulation

The first MMF in the United States was the Reserve Primary Fund (RPF) which was launched in 1971.36 Since then, with an initial period of rapid growth in 1974, the MMF sector has remained largely successful over its archrival banks because of its ability to offer higher interest rates than bank deposit accounts.37 Until its repeal in 2011, banks were restricted by a piece of legislation called “Regulation Q,” which encapsulated the Federal Reserve’s prohibition on banks paying interest on demand deposit accounts.38 Recognizing the economic advantage Regulation Q gave to MMFs, between 1980 and 1986, to help banks compete, Congress passed legislation that permitted them to create equivalents called money market deposit accounts (MMDA).39 Like MMFs, MMDAs have no limits on the interest depositors can earn.40 Despite initial success, however, MMDAs have not seen the same level of success as MMFs.41

MMFs became even more attractive to investors when they started to emulate bank-like features, such as check writing.42 By adding these features to existing investor-friendly characteristics such as a stable NAV and on-demand redemption, investors perceived MMFs as having the same benefits of a deposit bank account—safety and liquidity—but with better returns.43 This “perceived” stability of the MMF sector has been buttressed by its track record: in forty-one years only two funds have

35 See FSOC Report 2012, supra note 7, at 38, 75. About 40% of euro MMFS are comprised of external assets, mainly those of U.S. dollar and pound-sterling denominated debt securities issued by non-euro bank area banks. And in some cases U.S. funds met over 50% of European banks’ short-term funding needs. See also Ansidei et al., supra note 4, at 9–11.
36 Macey, supra note 26, at 138.
37 Id.
40 Id.
41 See id. at 240–41.
42 See Birdthistle, supra note 16, at 1163–64.
43 Money Market Funds, supra note 13 (“Pursuant to Section 22(e) of the Investment Company Act of 1940, registered open-end companies may not suspend the right of redemption and must pay redemption proceeds within seven days, except in certain emergencies or for such other periods as the Commission may by order permit for the protection of security holders of the company.”); Birdthistle, supra note 16, at 1163–64.
broken the buck. It has been asserted, however, that there are numerous other times where funds would have broken the buck but for sponsors stepping in to consume those losses. From a positive angle, this is sign of the ability of MMFs to self-medicate rather than pass on losses to shareholders or taxpayers.

MMFs are products subject to securities markets regulation. Hence, in the United States, the funds are regulated by the SEC. And, contrary to what pro-reformers may suggest, MMFs are highly regulated. Like other mutual funds, they are governed by the Investment Company Act of 1940 (ICA). In addition MMFs must comply with SEC rule 2a-7, which places strict requirements on the funds’ investments. Undoubtedly, existing extensive SEC regulation is warranted because these instruments play an indispensable role in the U.S. capital and short-term funding markets. Even in the current economic climate of increased redemptions and general market instability, MMFs manage approximately 2.564 trillion USD in assets.

As mentioned earlier, for the greater part of their history MMFs have been allowed to use penny-rounding method pricing and amortized cost accounting in order maintain a stable NAV. This rule persists today, but there was a period of time where the SEC questioned the prudence of allowing MMFs to use amortized cost accounting. In 1975, the SEC

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45 In her testimony before the Senate Committee on Banking, Housing, and Urban Affairs on June 21, 2012, Schapiro stated that “[b]ased on an SEC staff review, sponsors have voluntarily provided support to money market funds on more than 300 occasions since they were first offered in the 1970s.” Mary L. Schapiro, Testimony on “Perspectives on Money Market Mutual Fund Reforms”, (June 21, 2012), available at http://www.sec.gov/news/testimony/2012/ ts062112mls.htm#P16_4617. Commissioner Aguilar has highlighted, however, that the Commission has received letters questioning the “accuracy, veracity, and credibility of an SEC staff list of 300 money market funds that received sponsor support.” Luis A. Aguilar, Commissioner, U.S. Sec. & Exch. Comm’n, Statement Regarding Money Market Funds (Aug. 23, 2012) [hereinafter Aguilar Statement], available at http://www.sec.gov/news/speech/2012/spch082312laa.htm.

46 Money Market Funds, supra note 13.


48 17 C.F.R. § 270.2a-7; Money Market Funds, supra note 13.

49 MONEY MARKET MUTUAL FUND ASSETS FOR THE WEEK ENDED WEDNESDAY, OCTOBER,3, INV. CO. INST. (Oct. 4 2012), http://www.ici.org/research/stats/mmf/mmf_10_04_12 (Taxable governmental funds accounted for the lion share of this amount, and institutional investor funds managed approximately $1.674 trillion USD. During this period, the assets of retail MMFs increased by $2.49 billion to $889.81 billion.).

50 Fisch & Roiter, supra note 17, at 1012–15.

criticized amortized cost valuation for being mechanical and lacking of any judgment on the part of the board of directors. The Commission also criticized the approach for its opacity. “[I]t may result in periods during which the value of a fund’s portfolio, as determined by amortized cost, is significantly higher or lower than the price the fund would receive if it liquidated the portfolio at prevailing market prices.”

The Commission, therefore, found the mark-to-market accounting approach more favorable for certain types of securities and in 1977 formally adopted the rule that prohibited MMF managers from using amortized cost valuations, except for securities with a remaining maturity of 60 days or less. Notwithstanding this rule, the SEC routinely granted exemptions to investment advisors who submitted requests. The Commission continued to justify its deviation from the position that amortized cost valuation was unfavorable by stating that such a valuation technique could protect investors if used properly. So finally in 1983 the SEC adopted Rule 2a-7, which provides that MMFs can use amortized cost accounting or the penny-rounding approach, subject to a few enumerated conditions.

These risk-limiting conditions concern diversification, liquidity, maturity, and credit quality. The funds have to invest most of their assets in first tier securities, such as treasury bills, which have the highest credit ratings. A limited portion of assets can be invested in securities with the second highest rating. MMFs are also limited to investing only a portion of their assets in a particular security. In addition, from earlier on, the funds’ prospectuses had to disclose that the funds were not insured or guaranteed. The fund’s board is periodically required to shadow price the amortized cost NAV of the fund’s portfolio against the portfolio’s mark-to-market NAV. Further, the board must promptly consider whether it should discontinue using amortized cost valuation, break the buck, or pursue some other course if the difference between these two values are one-half of one percent, or $0.005 per share.

28999 (June 7, 1977) [hereinafter Release No. 9786] (permitting MMFs to use amortized cost accounting for securities with remaining maturities of 60 days or less).
52 See Release No. 8757, supra note 14, at *5.
53 Id.
54 See Release No. 9786, supra note 51.
56 Fisch & Roiter, supra note 17, at 1012–15.
58 See Release No. 29132, supra note 2.
59 17 C.F.R. § 270.2a-7(c)(3).
60 Id.
61 Id. § 270.2a-7(c)(4).
62 Id. § 270.34b-1.
63 See Release No. 29132, supra note 2.
64 Id.
2. Post-Crisis Regulatory Reform

MMFs did not cause the financial crisis, but they contributed primarily by causing severe dislocations in the short-term funding markets to the detriment of companies and financial institutions. The events of September 2008 also demonstrated the vulnerability of MMFs to destabilizing runs. Runs were triggered by the RPF’s announcement that it would be breaking the buck. The drop in the RPF’s NAV from $1.00 to $0.97 per share was a direct result of the Lehman Brothers bankruptcy in mid-September. At the time of the bankruptcy, the RPF had $785 million USD invested in Lehman’s commercial paper. The fund had to write its Lehman holdings down to zero, which affected its share price and eventually led it to break the buck. Institutional investors panicked when they heard of the write down and began to redeem significant amounts of their investment—$300 billion in one week. A run on MMFs by institutional investors, as opposed to retail investors, was significant for the capital markets because those investors accounted for a large share of assets during that period.

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65 REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 2.
67 See Reserve’s Press Release, supra note 1; see also Jennifer Ablan, Reserve Primary Fund drops below $1 a share amid Lehman fall, REUTERS (Sept. 16, 2008), http://uk.reuters.com/article/2008/09/16/us-reservefund-buck-idUKN1669401520080916.
68 Reserve’s Press Release, supra note 1.
69 Id.; Schapiro, supra note 66, at A15.
70 Reserve’s Press Release, supra note 1.
72 Factbook 2009, INV. CO. INST., http://www.icifactbook.org/2009/fb_sec2.html#2.15 (“Institutional MMFs—used by businesses, pension funds, state and local governments, and other large investors—had inflows of $525 billion in 2008, following inflows of $483 billion the previous year.”).
Furthermore, the run on the RPF had a number of implications. The first is known as the first mover advantage; if the fund honored the requests of all redemption orders coming in, shareholders who redeemed early would exit with their entire holdings, while other (mostly retail) investors would have recovered next to nothing of what remained of the fund’s depleted assets.\(^\text{73}\) Second, out of unwarranted fear that their own funds would meet the same fate as the RPF, investors of other MMFs sought to redeem shares from their respective funds.\(^\text{74}\) And third, as unprecedented runs on MMFs occurred, fund managers grew as risk averse as the investors and retained their cash positions or invested mainly in treasury bills rather than commercial paper.\(^\text{75}\) As a result, overnight companies did not have access to the capital needed to finance day-to-day business operations.\(^\text{76}\) The strain was placed not only on U.S. companies but also institutions overseas, particularly Europe, that rely on U.S. MMFs for short-term financing.\(^\text{77}\)

The freeze in the credit markets prompted the federal government to make an unprecedented intervention.\(^\text{78}\) The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, created by the Federal Reserve Board, was used to extend credit to banks to finance their purchase of commercial paper from MMFs.\(^\text{79}\) In addition, the Treasury Department implemented the one-year Temporary Guarantee Program for Money Market Funds which guaranteed the investments of MMFs that maintained a stable NAV.\(^\text{80}\) These programs helped to stabilize and provide liquidity to the short-term markets, and to contain the run on MMFs.\(^\text{81}\) This was the first time in the forty-one years of the funds’ existence that the government had to extend such a guarantee.\(^\text{82}\) The funds did not support or request the program.\(^\text{83}\) And, overall, the program benefited rather than burdened taxpayers: the program netted the government an estimated $1.2 billion in fees paid by participating funds, and the government received no claims.\(^\text{84}\)

The vulnerabilities of MMFs that came to light during the financial crisis prompted the SEC to adopt rules to make the funds more resilient.\(^\text{85}\) The SEC’s primary objective was to make the funds less susceptible to runs and to reduce the consequences of runs on

\(^{73}\) Birdthistle, supra note 16, at 1178.
\(^{74}\) Id.
\(^{75}\) Id. at 1180.
\(^{76}\) See Release No. 29132, supra note 2, at 10061.
\(^{77}\) See Schapiro, supra note 66, at A15; see also supra text accompanying note 35.
\(^{78}\) See Release No. 29132, supra note 2, at 10061.
\(^{79}\) Id.
\(^{80}\) Id.
\(^{81}\) Id.
\(^{82}\) Id.
\(^{83}\) Id.
\(^{84}\) Id.
\(^{86}\) Release No. 29132, supra note 2.
\(^{88}\) See Release No. 29132, supra note 2, at 10062; Schapiro, supra note 66, at A15.
shareholders. The rules adopted in 2010 also improved the ability of the SEC to oversee MMFs. These rules enhance risk-limiting constraints on the funds by imposing additional credit-quality standards, requiring the funds to reduce the maximum weighted average of their portfolios, and by requiring them to maintain buffers that can buttress their ability to withstand sudden demands for redemption. Fund managers are required “to stress test their portfolios against potential economic shocks such as sudden increase in interest rates, heavy redemptions, and potential defaults.”

The SEC’s 2010 reform also amped up disclosure requirements for MMFs: MMFs must file detailed data on their holdings every month and this information is made available every 60 days. There also are tighter standards in place on repurchase agreements that are collateralized with non-government securities. In the event that a fund does break the buck, the rules provide a means for the fund to suspend redemptions promptly and liquidate its portfolio in an orderly manner that is fair to investors and that limits contagion.

Despite these extensive reforms, Timothy Geithner and Mary Schapiro (Secretary of the Treasury and Chairman of the SEC, respectively) have been especially vocal about the need for additional rules to address the structural flaws of MMFs. The Dodd-Frank-created FSOC is poised to lead the way for these reform efforts. Among the members of the FSOC are the Secretary of the Treasury, the Comptroller of the Currency, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the SEC, and the Chairperson of the Federal Deposit Insurance Corporation. FSOC will provide comprehensive monitoring to ensure the stability of the U.S. financial system, and is charged with identifying threats to financial stability, responding to these emerging risks, and promoting market discipline.

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86 See Release No. 29132, supra note 2, at 10062.
87 Id. at 10.
88 Id.; REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 3.
89 See Release No. 29132, supra note 2, at 10062.
90 See Ansidei et al., supra note 4, at 28.
91 REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 3.
92 Release No. 29132, supra note 2, at 10062; REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 3.
94 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 111-12, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 12 U.S.C.) [hereinafter Dodd-Frank Act] (Dodd-Frank was enacted in response to the recent economic crisis “[t]o promote the financial stability of the United States . . . . to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”).
95 Id.
C. Regulatory Framework of MMFs in the Europe and the Financial Crisis

1. Overview of European MMFs and Regulations

ESMA was created in 2010 as a response to the shortcomings in the financial system exposed by the economic events of 2007–2008. Prior to ESMA guidelines, “despite the fact that financial institutions operate[d] across borders using the single market, supervision had remained mostly at national level, uneven and often uncoordinated”; there was no regulatory framework for MMFs at the European level. The treacherous economic events that transpired in recent years revealed, however, that nationally based supervisory models have lagged behind the financial reality of the interconnected European markets. As a result, the European Commission created ESMA as a replacement for ESMA’s less comprehensive predecessor, the Committee of European Securities Regulators (CESR). Among other powers, ESMA has the authority to (1) draft technical standards that are legally binding in E.U. Member States, (2) monitor systemic risk of cross border financial institutions, and (3) supervise credit rating agencies. ESMA’s work on securities legislation contributes to the development of a single rule book in Europe.

The regulatory framework for MMFs in Europe is governed not only by ESMA’s guidelines that came into force in July 2011, but also the Undertakings for Collective Investment in Transferable Securities Directive (UCITS), other E.U. legislation on managed funds, and national laws. The vast majority of MMFs in Europe comply with the provisions of UCITS. UCITS is the current E.U. legislation for investment funds and is the basis for an integrated market facilitating the cross-border offer of collective investment funds; hence, “once registered
in one E.U. country, a UCITS fund can be freely marketed across the EU." 105 UCITS, which came into existence in 1985 and has been subject to subsequent revisions, defines rules in respect to eligible assets, leverage, diversification and counterparty risk. 106

In addition, most CNAV funds comply with IMMFA’s industry code. 107 IMMFA is the trade association which represents the European triple-A rated MMF industry. 108 There are roughly 90 member funds and 24 investment managers. 109 All IMMFA funds are CNAV funds. 110 IMMFA’s code seeks to protect investors in IMMFA funds by establishing general management, compliance, and disclosure obligations, and by imposing minimum standards for risk management. 111 Requirements imposed by the code are similar to those governing MMFs in the United States. 112 The Code addresses liquidity, escalation procedures when the value of a security differs with mark-to-market valuation, and credit ratings. 113

Although the effect of the financial crisis on European MMFs was far less dramatic than it was in the United States, it spurred a number of regulatory changes in Europe. 114 First, as previously mentioned, ESMA was created to monitor the securities industry and to create a single rule book for all E.U. member countries. 115 Second, ESMA’s guidelines established two new classifications of MMFs: short-term money market funds (STMMF) and MMFs. 116 The primary distinction between these two is that MMFs have longer weighted average maturity (WAM) and weighted average life (WAL) than STMMFs. 117 STMMFs include both CNAV and VNAV funds. 118 MMFs are all VNAV funds: that is, MMFs must have a floating NAV. 119

106 Ansidei et al., supra note 4, at 6, 34.
107 Id. at 6.
112 Ansidei et al., supra note 4, at 7.
113 Id.
114 Id. at 4.
117 ESMA Guidelines, supra note 116, at 7–8.
118 Ansidei et al., supra note 4, at 5.
119 Id. at 6.
European funds cannot use amortized cost valuation because of “the fact that the longer the average maturity of MMF assets, the greater the risk of mispricing.”\(^\text{120}\) In addition, MMFs must invest in high quality instruments which are those that are rated highly or have some equivalent in the case of those instruments that are not rated.\(^\text{121}\) Whether or not an instrument is of high quality is a determination made by the management of the company.\(^\text{122}\) Further, under ESMA’s guidelines, MMFs must provide daily price and NAV calculations.\(^\text{123}\)

2. Comparison Between the U.S. and European Regulatory Framework

Despite many similarities between the regulatory framework for MMFs in the United States and in Europe, there are also critical differences. Primarily, unlike the United States, Europe traditionally has two types of MMFs: CNAV funds—the U.S. model—and VNAV funds.\(^\text{124}\) Another significant point of divergence between the two regimes is that in the United States there is a lot more reliance on credit rating agencies, while in Europe credit rating is just one of many factors to be considered when assessing the creditworthiness of an instrument.\(^\text{125}\) Promisingly, under current SEC proposals, this heavy reliance on credit rating may soon be eliminated.\(^\text{126}\) Furthermore, unlike the United States where the board may have to consider breaking the buck if the difference between amortized cost and the shadow price is one-half of one percent, in Europe IMMFA only requires the fund manager to implement procedures to narrow the gap if the variance is beyond a preset level.\(^\text{127}\)

Dissimilar to the SEC, European regulators are not as prescriptive regarding the amounts of liquid assets held by MMFs.\(^\text{128}\) Rather, the funds are only directed to ensure that assets are liquid enough to meet all potential redemption requests.\(^\text{129}\) IMMFA does require, however, that 5% of assets be held in daily liquid assets and 20% in weekly.\(^\text{130}\) Under the recent changes, a maximum of 5% of total assets can be illiquid. On the other side of the pond, the SEC requires taxable MMFs to hold 10% daily liquid assets, while other MMFs must have 30% weekly liquid assets.\(^\text{131}\)

\(^{120}\) Id. at 7.
\(^{121}\) Id. at 6.
\(^{122}\) Id.
\(^{123}\) Id. at 41.
\(^{125}\) Ansidei et al., supra note 4, at 41.
\(^{126}\) See Release No. 29132, supra note 2, at 10066 (“The debt crisis of 2007–2008 also has given us concern about the reliability of these ratings.”).
\(^{127}\) Ansidei et al., supra note 4, at 38.
\(^{128}\) Id. at 7.
\(^{129}\) Id.
\(^{130}\) Id. at 42.
\(^{131}\) Id.
In terms of similarities between the two regimes, both the United States and Europe impose strict requirements on asset quality, diversification, maturity, and liquidity. Both require MMFs to invest in high quality assets. Both also set certain limits in respect to WAM and WAL: U.S. MMFs and their European equivalent, STMMFs, must have a WAM of 60 days and a WAL of 120 days. Like the United States, Europe imposes strict disclosure requirements on funds: that is, fund documentation must carefully highlight the distinction between MMFs and bank deposit accounts, daily calculation of NAV must be provided to investors, and monthly and quarterly data must be disclosed to fulfill the European Central Bank requirements.

Another similarity is that Europe’s CNAV fund managers are required to periodically calculate the fair market value of the funds and compare it to the amortized cost. Like U.S. MMFs, Europe’s CNAV funds carry the top ratings from rating agencies, and both regimes require funds to be in a position to process redemption requests. In Europe, the rules provide that redemption or subscription can be suspended in exceptional circumstances to protect investors. Similarly, in the United States, suspension is warranted where the fund is concerned that it will break the buck and irrevocably liquidate.

III. ANALYSIS AND RECOMMENDATION

A. Reform Initiatives

Despite extensive post-crisis reform, especially in the United States, both regimes are advocating for further rules to be imposed on MMFs. In Europe, the European Commission has focused its analysis on MMFs as one of many sectors within the shadow banking system—entities that perform bank-like functions but which are not subject to banking regulations—that need additional oversight. ESMA and IMMFA have been a part of this discussion. ESMA also has been
working on the issues surrounding the shadow banking industry through collaboration with the European Systemic Risk Board (ESRB) and through UCITS directives.\textsuperscript{141}

In the United States, a recent announcement by the SEC Chairman, Mary Schapiro, that the Commission will no longer push for reforms sent shockwaves through the public, as many interpreted this as a sign that industry lobbyists had won and MMFs were off the regulatory hook.\textsuperscript{142} Schapiro urged other policymakers to “consider ways to address the systemic risks posed by money market funds” after three Commissioners declared that they would not vote at that time to propose reform.\textsuperscript{143} Urging other regulators to take up the baton, Schapiro said it should now be clear to policymakers that the SEC will not act on the issue of MMF reform.\textsuperscript{144} The Chairman has pointed out that there has already been two years of study on the susceptibility of MMFs and on the effect of the 2010 reforms.\textsuperscript{145}

The announcement and the process leading up to the Chairman’s statement were also contentious among the Commissioners, with Paredes and Gallagher criticizing the discourse for being rife with “misunderstandings and misconceptions.”\textsuperscript{146} Commissioners Paredes and Gallagher, who believe that the “issue is squarely within the expertise and regulatory jurisdiction of the SEC,” have justified their refusal to act on the fact that the Chairman’s ideas are not supported by the necessary research data or analysis and are unlikely to protect investors.\textsuperscript{147} Furthermore, according to Paredes and Gallagher, Schapiro’s proposals would impose significant costs, introduce new risks, and would be ineffective in achieving the intended purpose.\textsuperscript{148} The Commissioners believe that it is premature to pass further legislation at this point in time.\textsuperscript{149} Rather, they are open to discussions going forward and have called on economists to become engaged in the discourse.\textsuperscript{150} In the same vein, Commissioner Luis Aguilar has called for further studies on the issue before the imposition of any additional regulations.\textsuperscript{151}

Overall, regardless of superficial appearances, lobbyists have not won.\textsuperscript{152} Even if the SEC were to end the “fund fight,” the Treasury Secretariat of the Fin. Stability Bd. (May 20, 2011), available at http://www.immfa.org/press/responseFSB.pdf (responding to the FSB’s Green Paper on Shadow Banking).

\textsuperscript{141} See Reply of ESMA to the European Commission’s Green Paper on Shadow Banking, supra note 8, at 2.


\textsuperscript{143} Schapiro Press Release, supra note 7; Schapiro, supra note 66, at A15.

\textsuperscript{144} Id. Schapiro, supra note 66, at A15.

\textsuperscript{145} Id.

\textsuperscript{146} Gallagher & Paredes Statement, supra note 9.

\textsuperscript{147} Id.

\textsuperscript{148} Id.

\textsuperscript{149} Id.

\textsuperscript{150} Id.

\textsuperscript{151} See Aguilar Statement, supra note 45.

\textsuperscript{152} See Geithner Letter, supra note 93 (Treasury urging further reform); Dan McCrum & Shahien Nasiripour, US Money Funds Thwart SEC Reform Plans, FIN. TIMES (Aug. 28, 2012, 10:35
Department is not backing down. To move the discussion along, the Treasury proposed that the PWG “prepare a report on the fundamental changes needed to address systemic risk and to reduce the susceptibility of MMFs to runs.” The PWG published its report in October 2010 and this paper will expound on some of the reform options discussed in the report below. In addition, Tim Geithner sent a letter to the FSOC urging the issuance of new rules. And even without the nudging of the Treasury, the FSOC has indicated that it is “in the market for more oversight.” Most recently, the FSOC voted to offer three distinct reform alternatives and said it would recommend one or a combination of those to the SEC for adoption.

B. Effectiveness of Regulations and Whether Additional Rules Should be Imposed

Before exploring the main reform options being proposed and the merits of those proposals, it is important to consider the preliminary question of whether further reform is needed or recommended in the first place. This article argues that the additional rules imposed on MMFs in 2010 by the SEC are fully capable of addressing the liquidity and transparency concerns underlying the current debate. If, after in depth study, data arises to suggest a need to further buttress the funds’ ability to sustain runs of current reform proposals, a mandatory capital buffer will prove to be the most viable option. This is the option that is least likely to cause investor flight. It is also the option that is best tailored to address one of the main concerns of regulators pushing for further reform: the intolerance of fund investors to even slight degrees of fluctuation. These ideas will be expounded under Reform Options, below.

This paper stops short of arguing that no additional reform is ever needed because although the funds have done a superb job of self-medicating throughout their history, they are under no legal obligation to

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154 REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 1.

155 Id.

156 Geithner Letter, supra note 93.

157 Play on the title of Schapiro’s article. See Schapiro, supra note 66, at A15; see also FSOC Report 2012, supra note 7, at 11.


159 See Release No. 29132, supra note 2.

160 See REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 2.

161 Id.

162 See Schapiro, supra note 66, at A15.
support their portfolios. Of course, investors must understand that the price paid for investment rewards is the risk they assume: the risk that they may lose money. So the very idea of a legal obligation on directors to protect investment cuts against the inherent nature of investments. Nonetheless, where MMFs are emulating bank accounts and are branded on “guarantees” of a constant dollar per share, it is not irrational that regulators advocate that either the funds become subject to bank-like regulations (a bad idea) or implement measures that will provide reassurance to their risk-averse investors in times of crisis.

On this latter point scholars and practitioners, as well as this paper, will be quick to highlight that, pursuant to the SEC’s heightened disclosure requirements, directors make it very clear in fund documentation that return “guarantees” are conditional and that MMFs are not the equivalent of bank accounts. This, however, may be cold comfort to pro-reformers who perceive that the funds’ actions speak louder than the words on paper, which largely stems from the fact that MMFs are structured like bank accounts, use language of “guarantees,” and in the past have buttressed investors’ inaccurate perceptions of stability by consuming losses rather than passing them on to their clients. Hence, extending that logic, the concept of breaking the buck is in fact foreign even to sophisticated MMF investors. Having the responsibility for the preservation and stability of the financial system, regulators are not likely to hang their hats on track record or sponsors’ ethics. Expressed quite aptly by Schapiro, “when regulators identify a potential systemic risk” it should be addressed.

Therefore, the willingness to concede to further limited reform in the form of a capital reserve is based on the reluctant acceptance of the idea that regulators’ concerns are well-founded. Before exploring what limited reform should look like, this paper sides with the dissenting SEC Commissioners in cautioning regulators to proceed only after enough study has been done and a healthy ventilation of the advantages and disadvantages of competing policy positions has taken place. This approach is imperative to prevent an outcome akin to what Professor Roberta Romano calls “quack governance”—the idea that on the heels of economic crises legislators, motivated by politics and media frenzy, enact rules that are misconceived and lacking in careful consideration.

164 See Birdthistle, supra note 16, at 1180–81; Perlow, supra note 44, at 79.
165 See 17 C.F.R. § 270.34b-1.
166 See Fisch & Roiter, supra note 17, at 1005.
167 See generally Birdthistle, supra note 16.
168 See Perlow, supra note 44, at 78.
170 Aguilar Statement, supra note 45; Gallagher & Paredes Statement, supra note 9; Romano, supra note 11, at 1594–1602.
171 See Romano, supra note 11, 1594–1604.
Reform initiatives are shaping to meet many of the elements of quack governance addressed by Romano. First these laws are enacted in an economic crisis environment. The SEC’s 2010 amendments were in response to the financial crisis of 2008 and current reform discussions are occurring against the backdrop of the Great Recession. Second, quack regulations respond to “populist backlash against corporations and/or markets.” The public outrage against corporations during the 2008 crisis cannot be overstated. The “Occupy Wall Street” movement that occurred across the country also illustrates this point. And although MMFs did not ask for, or in fact use government funds to stem their losses, there are those that suggest otherwise.

Another prong in the quack governance analysis is that these are laws at the federal rather than state level. Here, this is obviously met. But one of the most telling signs of the negative direction in which MMF regulatory reform is headed appears in the element that states that quack regulations are usually not novel proposals but rather options that have been rejected in the past. In the current regulatory discussion, one of the main and most contentious options being touted is that MMFs be required to float their NAVs. As has been discussed in this paper, this is not a novel proposal; it was considered by the SEC but ultimately not accepted.

And finally, under quack governance, empirical evidence supporting the proposal is mixed or unsupportive. The majority of Commissioners have pointed out that the changes advocated by Schapiro are not supported by the requisite data and analysis. In addition, no studies have been done to show that the 2010 amendments are not adequate in adding the level of resilience being required by regulators.


173 See Romano, supra note 11, 1591–1594.

174 Quack Federal Corporate Governance Round II, supra note 172, at 1796.

175 See id.


177 See supra note 51 and accompanying text.

178 See Quack Federal Corporate Governance Round II, supra note 172, at 1796.

179 Aguilar Statement, supra note 45; Gallagher & Paredes Statement, supra note 9.

180 Aguilar Statement, supra note 45; Gallagher & Paredes Statement, supra note 9. After this paper was written, the SEC’s Division of Risk, Strategy, and Financial Innovation submitted a report to address questions posed by Commissioners Aguilar, Paredes, and Gallagher in their September 17, 2012 memo to Chairman Schapiro and Director Lewis. See Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher, Nov. 30, 2012, http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf.
In fact, the empirical evidence that exists shows that because of the 2010 reform, MMFs can meet substantial redemption requests. Even European commentators have observed the effectiveness of the 2010 reforms. These commentators credit the 2010 reforms as one of the main reasons that “[r]ecent figures on U.S. money market funds show a decline in volatility of the ‘shadow NAV’ of U.S. prime MMFs.”

Prior to imposing additional rules, regulators should consider how existing rules can be improved and should focus on the sectors of the financial industry that actually cause the crisis—the RPF was forced to “break the buck” in the midst of a financial crisis of historic proportions. Additionally, as Commissioner Aguilar has pointed out, the cash management industry is very large and before structural changes are made to just one slice—the MMF sector—macro questions must be addressed, especially for pooled vehicles that are excluded from oversight. A starting point for improvement of existing rules is to curb the over reliance on credit ratings. As is the case in Europe, credit ratings should be only one factor. The International Organization of Securities Commissions (IOSCO) has stated that mechanistic reliance on external ratings should be avoided in order “to reduce herding and ‘cliff effects’ and the risk of fire sales.”

Summarily, before the rules regulating MMFs are amended, in-depth studies and analyses must be done. The results of this investigation must “inform any proposal, not merely accompany it.” Over their forty-one year history, MMFs have proven to be stable and productive. They are heavily regulated and there is no need for additional extensive regulations. Under existing empirical evidence, the SEC’s 2010 reform has substantially and adequately buttressed the funds’ ability to withstand sudden, large redemptions should another crisis occur. The extensive reform being proposed by some is likely to impose significant costs on issuers and investors as well as introduce other risks. This point will be explored in the following section. The section also will fully address the concept of a capital reserve, the one reform option that this paper suggests will deliver benefits without substantial costs.

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184 Gallagher & Paredes Statement, supra note 9.
185 Ansidei et al., supra note 4, at 15.
186 Gallagher & Paredes Statement, supra note 9.
187 Aguilar Statement, supra note 45.
188 Ansidei et al., supra note 4, at 16.
189 IOSCO REPORT, supra note 138, at 17.
190 Aguilar Statement, supra note 45.
191 See Perlow, supra note 44, at 78.
193 Gallagher & Paredes Statement, supra note 9.
194 See id.
C. Reform Options

Many reform options being advanced fall on the side of being too costly or operationally challenging, and are likely to chase investors away from MMFs to riskier instruments. To date, arguably the most promising of these options is a rule that would require MMFs to have a capital buffer or loss reserve. Further along the continuum, ranging from favorable to least favorable, the other noteworthy options include: private emergency liquidity facility; a two-tiered system akin to the European framework; insurance requirements; redemption in kind or redemption holdback; floating NAVs, and transforming MMFs into quasi-banks or treating them as special purpose banks subject to bank-like requirements. This paper will discuss capital buffers, floating NAVs, and briefly address some of the other options.

1. Capital Buffers

If the cost of preserving a capital reserve does not significantly reduce the fund’s yield, this is possibly the best reform option. It is also one of Schapiro’s main recommendations, and European commentators have stated that this is one of the options that regulators should definitely consider. When coupled with regulations the SEC already has in place, this would buttress the funds’ ability to withstand runs and their ability to absorb losses without breaking the buck (which is a rare occurrence regardless). It also would adequately address the issue of first mover advantage. In addition, investment managers would feel a certain level of preparedness and, during a crisis, would not give in to the urge to retain cash position to the detriment of the short-term funding market. Schapiro’s recommendation of requiring an amount of less than 1% of the fund’s assets for the buffer is reasonable. However, this paper does not agree that the capital buffer should be coupled with a 3%, 30-day holdback, as suggested by Schapiro. With the liquidity buffer requirements put in place by the 2010 amendments, the capital reserve would work effectively to achieve the intended purpose.

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196 See id. at 2–3.
197 See id. at 2.
198 See Schapiro Press Release, supra note 7; Ansidei et al., supra note 4, at 42.
199 Cf. Schapiro Press Release, supra note 7 (highlighting these two concepts as two of the main components of MMF’s structural flaw).
200 See Birdthistle, supra note 16, at 1180.
202 Id.
203 See Release No. 29132, supra note 2, at 10074 (“[E]ach money market fund [is required to] hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions in light of its obligations . . . .”).
Everything comes at a cost, and the maintenance of a capital reserve is not an exception to that maxim. Most likely the cost of a loss reserve is going to be borne by investors, not fund managers. Higher prices that significantly cut into returns would send investors running back to banks, where they would get security and yields that MMFs would start to offer under a costly capital reserve system. Another concern is that imposing this as a mandatory requirement for a fund’s operation would create an uneven playing field, where larger funds with prominent sponsors can build their reserve overnight and get a head start on smaller funds that would take years to get this reserve in place. But in today’s competitive marketplace, there is little doubt that investment managers can find ways to raise capital in a short period of time and repay their obligation over years to come.

2. Floating NAVs

Arguably, the most controversial reform option on the table in the United States is the idea that MMFs should be compelled to float NAVs. Recall that the funds may currently utilize amortized cost accounting to allow them to maintain a stable NAV. If this reform option were to be realized, MMFs would be forced to use mark-to-market accounting. This option reflects the tone of the European rules. ESMA’s 2010 guidelines provide that MMFs should not be allowed to use fixed NAVs, as they are more sensitive to interest rate changes than short-term MMFs. Hence, under ESMA’s guidelines European MMFs, which have longer WAM (weighted average maturity) and WAL (weighted average life), can only use floating NAVs for their price calculation. IOSCO also subscribes to this idea.

As discussed earlier, this is not a new proposition. The SEC implemented and ultimately rejected a requirement to float NAVs. As a general matter, there are very good arguments for and against floating NAVs. Proponents argue that the “fiction” of a stable NAV heightens funds’ vulnerability to runs because it creates the perception that funds are as risk-free and stable as bank accounts, and no amount of disclosure on the part of the fund managers would disabuse investors of this notion. Hence, in the scenario where a fund must break the buck,
investors panic and rush for the door.\textsuperscript{215} If funds abandon this fiction, however, and adopt a floating NAV that reflects the underlying value of the securities in their portfolios investors would not feel a need to redeem their shares at the first sign of distress.\textsuperscript{216}

Opponents of a floating NAV have the stronger argument if experience is the ultimate teacher: funds with floating NAVs in Europe were not insulated from runs.\textsuperscript{217} Furthermore, even proponents of floating NAVs acknowledge that implementing this proposal would be a drastic shift for an industry that meteored to success primarily on the basis that the funds maintain a fixed NAV.\textsuperscript{218} There is a significant chance that a bulk of investors would withdraw their capital, a consequence that would have a deleterious effect on the financial system.\textsuperscript{219} At least one study has confirmed the likelihood of this unfavorable outcome.\textsuperscript{220}

Investor flight would create a number of problems: (1) investors would move assets to unregulated or less regulated industries that would heighten systemic risks, (2) MMFs’ loss of capital would upset the short-term funding markets and deny businesses the liquidity that normally comes from the funds’ investment in commercial paper, and (3) investors’ responses to fluctuating NAVs is still quite unpredictable.\textsuperscript{221} In addition, as ESMA has noted, there may not be much of a difference between the NAV of funds that use amortized cost accounting and those that mark-to-market “as the underlying instruments will generally exhibit low asset price volatility.”\textsuperscript{222}

It seems, therefore, that the primary reason for lobbying for a floating NAV is the idea that it would caution investors about the risks inherent in MMFs, and the notion that hopefully with this knowledge, investors would acclimate to those risks.\textsuperscript{223} For all the potential negative consequences attributable to requiring MMFs to float their NAVs,\textsuperscript{224} this is not a good enough rationale. First, over the last number of years institutional investors have held the majority of MMF assets.\textsuperscript{225} There is no question that these are sophisticated investors who are aware there is

\textsuperscript{215} See Schapiro Press Release, supra note 7.
\textsuperscript{216} See Schapiro Press Release, supra note 7; IOSCO REPORT, supra note 138, at 7–8.
\textsuperscript{217} Coz Letter, supra note 124; REPORT OF THE MONEY MARKET WORKING GROUP, supra note 71, at 63.
\textsuperscript{218} See REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 4.
\textsuperscript{219} See Aguilar Statement, supra note 45; Gallagher & Paredes Statement, supra note 9.
\textsuperscript{221} REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 4.
\textsuperscript{222} Ansidei et al., supra note 4, at 15–16.
\textsuperscript{223} See, e.g., Schapiro, supra note 66, at A15.
\textsuperscript{224} See REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 4.
\textsuperscript{225} See supra note 72 and accompanying text.
no guarantee on returns and that MMFs, unlike banks, are not insured.\textsuperscript{226} Another point is that MMFs by their very nature attract risk-averse investors,\textsuperscript{227} whether they are retail or institutional investors. These investors use the funds as cash management vehicles to achieve two of their primary goals—liquidity and stability. Therefore, even if MMFs were to use a floating NAV, it is very likely that even slight fluctuations would send these investors running.

\textbf{3. Other Options}

Many other reform options can easily be ruled out for being too costly, operationally challenging, or very unlikely to achieve their intended purpose. For example, a private emergency liquidity facility may help the MMF industry stand its own liquidity protection cost, withstand outflows, and offer efficiency gains from risk pooling.\textsuperscript{228} However, there are structural, pricing, and operational hurdles that need to be overcome to make sure these facilities would be effective during a crisis, that they would not favor some MMFs business models over others, and that they do not unduly distort incentives.\textsuperscript{229} Similarly, before implementing the proposal of redemption in kind, the SEC would have to decide how the funds would distribute portfolio securities and when a fund must redeem in kind. As for insurance requirement, appropriate risk based pricing is going to be critical, and is very difficult to assess in practice.\textsuperscript{230}

Another option is to bifurcate the structure of MMFs to achieve a two-tiered system akin to that of the European framework; that is, there would be MMFs with stable NAVs and some with floating NAVs.\textsuperscript{231} However, as discussed above, this two-tiered system, which has been in place in Europe for decades, did not immunize the funds from losses in Europe.\textsuperscript{232} The only thing that would probably make this model more successful if implemented in the United States is the fact that regulators would also require some of the additional safeguards discussed above.\textsuperscript{233} But as has been discussed, there are a number of structural, operational and economic challenges that must be addressed before a number of these safeguards could be put in place.\textsuperscript{234}

\begin{footnotes}
\footnote{\textsuperscript{226} Macey, supra note 26, at 169.}
\footnote{\textsuperscript{227} REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 3.}
\footnote{\textsuperscript{228} Id. at 4.}
\footnote{\textsuperscript{229} Id.}
\footnote{\textsuperscript{230} Id. at 5.}
\footnote{\textsuperscript{231} Id. at 5–6.}
\footnote{\textsuperscript{232} REPORT OF THE MONEY MARKET WORKING GROUP, supra note 71, at 63.}
\footnote{\textsuperscript{233} REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, supra note 12, at 4–6.}
\footnote{\textsuperscript{234} Id.}
\end{footnotes}
IV. CONCLUSION

There are significant consequences to making extensive changes in the regulatory framework that would transform the business model on which MMFs have been successfully operating for over forty years.235 Extensive changes are likely to result in investor flight from the fund industry to other unregulated industries, thereby increasing systemic risks. In addition, these changes would have a negative impact on the short-term funding markets, since the fund industry play an indispensable role in those markets. Furthermore, with the interconnectedness of the global financial system and the prominence of the fund industry in that system, the negative impact of U.S. reform on the fund industry would have extra-territorial effect. The European experience is instructive of the fact that, like CNAV funds, funds that mark-to-market are not immune from economic crises. The European fund experience also has shown that effective regulation does not lie in the quantity of rules, but rather the quality of rules: European funds fared better than U.S. funds in the recent crisis although the SEC’s regulation was much more comprehensive.

Rather than hurriedly implementing additional rules that would amount to quack governance, regulators in the United States should, first, engage in further analysis and study and act only after sufficient empirical evidence exists to support any course of conduct chosen. Second, as suggested by Commissioner Aguilar, regulators should examine the cash management industry at the macro level, rather than just the MMF industry slice and address the larger concerns there. Only after these steps are taken should regulators move to affect an industry that has proven itself stable and reliable.

235 See Release No. 29132, supra note 2.