My name is Jerry Hawke and I am a partner at the law firm of Arnold & Porter. In recent months, I have represented Federated Investors, one of the largest managers of Money Funds in the United States, before the Financial Stability Oversight Council, the Securities and Exchange Commission, and other regulators as those entities have considered criteria for the designation of systemically significant nonbank financial institutions and have considered options for Money Fund reforms.¹ My statement covers seven key points.

The first hardly needs to be said, but it is central to the debate over regulation of Money Funds: Millions of investors – individuals, businesses, and governments – have come to rely upon the liquidity, stability, efficiency and returns provided by Money Funds.

Money Funds provide individuals with a better yield and more flexibility than bank products. They give corporate treasurers and institutional investors instant liquidity and diversification with minimal transaction costs. For balances above the $250,000 FDIC insurance

¹ Federated has served since 1974 as an investment adviser to Money Funds. Federated has more than thirty-five years in the business of managing Money Funds and, during that period, has participated actively in the development of the money market. The registration statement for Federated’s Money Market Management fund first became effective on January 16, 1974, making it perhaps the longest continuously operating Money Fund to use the Amortized Cost Method. Federated also received one of the initial exemptive orders permitting use of the Amortized Cost Method in 1979.

Mr. Hawke served as United States Comptroller of the Currency from 1998 to 2004. In that capacity he also served as a Director of the Federal Deposit Insurance Corporation, the Federal Financial Institutions Examination Council, and the Basel Committee on Banking Supervision. Prior to his appointment as Comptroller, Mr. Hawke served for 3½ years as Under Secretary of the Treasury for Domestic Finance, in which capacity also he served as a director of the Securities Investor Protection Corporation (1994-1998). He also served as General Counsel of the Board of Governors of the Federal Reserve System from 1975 to 1978.
limit, money funds provide greater safety than bank deposits. They provide both business and
government borrowers a significant amount of their short-term financing needs: Money Funds
account for investments in almost 40% of outstanding commercial paper, approximately two-
thirds of short-term state and local government debt, and a substantial amount of outstanding
short-term Treasury and federal agency securities.\(^2\) So, the question is – why do anything to
change the essential character of this product and take it away from, or impair its utility for, the
millions of investors and users who rely upon it?

The second point is this: If we change the essential character of Money Funds by forcing
them into the banking system, as some would do – thus converting equity into debt – we would
not only deprive investors of a vehicle they clearly find extremely useful, but we would
overwhelm the banking system. The notion that banks could absorb significant new inflows of
deposits and provide significantly more short-term financing for borrowers is purely fanciful.
For banks to absorb the $2.7 trillion currently invested in Money Funds would require
astronomical amounts of new equity capital to support the added leverage of the new deposits –
$172 billion, given a 6% leverage requirement. With banks already under heavy pressures to
increase their capital for the assets they currently carry, this would be impossible. Moreover, it
would vastly increase the size of the Federal safety net to cover such a volume of new FDIC-
insured deposits – not to mention the enormous amount of uninsured deposits that would be
added, in large part, no doubt, at those megabanks that will be considered systemically important
and too big to fail.

I would be the first to admit that, if there were a solid record of failures or losses caused by Money Funds, perhaps a different approach to regulation would be warranted. But – and this is my third point – as a former bank regulator, I look at the Securities and Exchange Commission’s record of regulating Money Funds as one of the greatest regulatory success stories of all times.

In the 40-year history of money funds, only two funds ever “broke the buck” – a small fund in 1996, which returned 96 cents on the dollar, and the Reserve Primary Fund in 2008, which ultimately returned 99.2 cents on the dollar. The cost to U.S. taxpayers in connection with these incidents has been a grand total of – zero, and the impact on Money Fund shareholders has been almost imperceptible.

During that same period, over 2,800 banks failed and another 592 were kept afloat through federal bailouts, at a cost to taxpayers of more than $164 billion. During the period from January 2008 through April 2011, as a result of the financial crisis caused by the burst of the housing bubble and the collapse of mortgage-backed securities investments, over 356 banks have failed, and even more would have failed if the federal government had not infused about $2 trillion in cash into the banking system. Further, to get banks back on their feet, the Federal Reserve has kept interest rates close to zero, so banks can borrow at almost no cost and lend at higher rates. With interest rates so low, banks do not have to compete for depositors’ funds, and

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they can afford to offer low interest rates on deposits. This is estimated to cost savers $350 billion each year.⁵

So, my fourth point is a question, albeit a rhetorical one: What caused this focus on Money Funds, and what is it that can conceivably justify major changes in regulation? The Reserve Primary Fund’s repricing, which resulted from its credit losses on Lehman commercial paper, surprised an already anxious market and led to further anxiety and uncertainty on the part of other Money Fund holders that funds in which they were invested would break the buck.⁶ That, of course, did not happen. To their great credit, the Federal Reserve and the Treasury understood that the underlying concern at that time was liquidity, and they implemented measured programs to provide liquidity and calm the market. There was no “bailout” of Money Funds. Indeed, no Money Fund called upon Treasury’s temporary insurance program. And the Fed program was quite consistent with the role expected of the Fed in times of financial stress – to provide liquidity by making advances on the security of acceptable collateral. These temporary programs in the end yielded profits to the Fed and the U.S. taxpayers of over $1.7 billion.⁷

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⁷ The Treasury created a form of insurance guarantee which was never called upon, experienced no losses, and earned about $1.2 billion in participation fees. Press Release, *Treasury Announces Expiration of Guarantee Program for Money Market Funds* (Sept. 19, 2009) (available at http://www.ustreas.gov/press/releases/tg293.htm). The Federal Reserve created a program to provide credit for banks and bank holding companies to finance their purchases of commercial paper from Money Funds. This program terminated with no credit losses and resulted in interest income of $543 million. Federal Reserve Board, *Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility* (available at http://www.federalreserve.gov/monetarypolicy/abcpmmmf.htm); Burcu Duygan-Bump, Patrick M. Parkinson, Eric S. Rosengren, Gustavo A. Suarez, and Paul S. Willen, QAU Working
In a real sense, Money Funds were not the cause of systemic problems, they were the victim of those problems. While Reserve undoubtedly made an improvident investment decision in its effort to reach for greater yield, mismanagement at Lehman and the government’s decision to allow Lehman to fail were the root causes of the liquidity crunch. The funds that were confronted with unusually high redemptions were not suffering asset quality or credit losses. They simply faced the prospect of incurring losses on good assets that had to be liquidated prematurely to meet redemptions.

The Dodd-Frank Act attempted to identify and address the fundamental causes of the financial crisis from which we are now emerging – the most important of which, in addition to grossly imprudent mortgage lending standards and the distribution of toxic mortgage-backed securities, were ineffective risk management, excessive leverage at large, interconnected nonbank financial institutions, over-reliance on short-term funding by those firms combined with inadequate liquidity contingency plans, and a lack of regulatory tools to wind down institutions without a federal bailout. Dodd-Frank gave regulators the tools to significantly control liquidity risks and such over-reliance on short-term funding. The SEC also has taken a number of steps to bring more transparency to balance sheets with regard to short-term borrowings.8

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The fifth point I would make is that, with the exception of the private Liquidity Exchange idea, there is not a single reform proposal that makes sense, in terms of the costs to investors versus the perceived need to wring every scintilla of risk from Money Funds. For example:

*Why impose a floating NAV on Money Funds, and undermine the utility of the stable NAV for businesses, municipalities, and individuals?* The overwhelming majority of comments posted on the SEC’s website have, after all, urged retention of the stable NAV and stressed its importance to their investments.

*Why impose a capital charge on Money Funds and lower returns for both small and large investors, when Money Funds have nothing but equity capital in the first place?* The notion of a capital requirement to protect other holders of capital makes no sense. We generally think of capital as a protection for creditors, not for other equity investors. I cannot think of another instance in which government policy has required an institution to provide an equity cushion for the benefit of other holders of equity. Moreover, as we have seen, bank-style capital, the value of which is dependent on the real value of bank assets, has not been enormously successful in maintaining bank solvency when poor credit judgments or adverse market developments have caused asset values to erode. Because of the SEC-enforced limits on the kinds of investments Money Funds can make, wide swings in asset values are extremely unlikely.

Even more problematic would be the creation of a non-transparent hidden capital reserve, like that used by banks in some foreign countries, rather than retaining clear
accounting standards, with Money Fund investors continuing to understand and bear the risks.

And why impose elaborate bank-style regulation and a massive supervisory apparatus on Money Funds, when it has not worked for banks? Money funds have had a stellar record with very simple and clear SEC rules.

The sixth point is that the Commission has ample existing authority to regulate Money Funds, and there is no need to add to or shift this authority. Last year, the SEC did a remarkable job of targeting specific areas of Rule 2a-7 for enhancements – such as further improving asset quality; shortening maturity limits; requiring greater diversification; enhancing disclosures – all with a view toward retaining the fundamental character of Money Funds and, most important, retaining their utility to a broad range of investors and users. In other words, the Commission managed to fine-tune its regulation, without throwing the baby out with the bathwater.

In addition to Rule 2a-7, which has been extraordinarily effective as preventative regulation, the Commission also has a broad range of authorities which enable it to step in and promptly resolve problems if and as they occur in any Money Fund. Money funds simply do not need, for example, the resolution authority of the FDIC under Dodd-Frank for systemically significant institutions, when the SEC already can –

- Require a Money Fund to immediately shift to a floating NAV if it departs from the stable NAV;
- Immediately intervene and force a court-supervised liquidation of a troubled Money Fund where the trustees are unwilling or unable to do so (a Money Fund’s
trustees have the initial authority to defer share redemptions and liquidate a fund in the first instance, thus treating all investors the same); 

- Utilize its emergency power under Section 12(k) of the 1934 Act to act by order in an emergency with respect to any matter subject to its regulation, including investment companies; 

- Use its authority under Section 25 of the Investment Company Act to intervene in respect of reorganizations and liquidations of investment companies; 

- Use its cease-and-desist powers under Section 9(f) of the Investment Company Act; 

- Obtain injunctive relief under Sections 36 and 40(d) of the Investment Company Act; 

- Impose civil money penalties on Money Funds and their related persons under Sections 9(d) and 40(e) of the Investment Company Act; 

- Bring a judicial action and invoke the Federal courts’ 1934 Act § 21(d)(5) equitable remedies powers; and 

- Bring a judicial action and petition the Federal court to invoke the All Writs Act powers to enjoin other proceedings that interfere with the court’s jurisdiction over the matter.⁹

The only “tool” the Commission lacks is the deep pocket of taxpayer funds to bail out an institution. And after Dodd-Frank, that tool may no longer be used – by any regulator, for any institution.

A final point: as part of the rulemaking process under Dodd-Frank, regulators have put forward, and Federated has filed comments on, a number of proposals regarding the designation, regulation, and resolution of systemically significant nonbank financial institutions. For the reasons detailed in those letters, designation of Money Funds as “systemically significant” under section 113 of Dodd-Frank would not be appropriate, nor should the FSOC direct the SEC to change the way Money Funds are regulated.

The one proposal that makes some sense with regard to further enhancements of Money Funds is that raised in the PWG report for providing Money Funds with access to reliable, private emergency liquidity facilities. The Investment Company Institute, working with its members, including Federated, has offered the idea of a Liquidity Exchange Facility for all prime funds. The Liquidity Exchange Facility would be chartered as a state bank or trust company, capitalized and funded entirely by the Money Fund industry. It would serve as a source of liquidity in times of market distress, and therefore is directly responsive to the situation presented in September 2008.

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10 See e.g., Letter to the Federal Deposit Insurance Corporation (Mar. 28, 2011) (attached).

11 “Prime” funds are those that invest in high-quality short term money market instruments including Treasury and government obligations, certificates of deposit, repurchase agreements, and commercial paper, but do not include tax-exempt, Treasury or government Money Funds. The Investment Company Institute’s (“ICI’s”) proposal for a private liquidity facility would be limited to prime funds. Due to their underlying assets, tax-exempt, Treasury or government Money Funds are not subject to the same credit risk profile as prime funds. Indeed, as reported by the ICI, investors actually shifted substantial sums from prime Money Funds to government Money Funds in September 2008 (“[I]nvestors redeemed $396 billion from prime money market funds and invested $294 billion in government money market funds from September 10, 2008 to October 1, 2008.”). Letter from Paul Schott Stevens, ICI, to Elizabeth Murphy, dated January 10, 2011) (available at http://www.sec.gov/comments/4-619/4619-49.pdf).
In the end, however, the case has not been made for changing a formula that has worked. Money Funds are effectively governed by liquidity and asset quality standards under Rule 2a-7 and Commission oversight. It certainly does not make sense to subject them to bank-like regulation, or to alter their fundamental characteristics in any way. Moreover, the SEC has recently strengthened Rule 2a-7, and there seems to be no pressing reason for immediate large-scale reforms. If any reforms are pursued, consideration should be given to the ICI’s suggestion of a new private liquidity facility. This would be the most effective means to allow Money Funds to continue to serve the needs of businesses, state and local governments, and other investors. The investors have clearly stated that they want the SEC to maintain the simple approach that has worked extremely well for Money Funds. At a time when the federal budget is constrained, imposing on Money Funds the bank regulatory approach of tens of thousands of on-site government examiners and tens of thousands of pages of laws and regulations – which has not worked to keep banks solvent – is not a realistic option.