03 01 2010 Ci scusi, ma la Legge non ci consente di restituire. I Suoi Soldi sono congelati

This Is The Government: Your Legal Right To Redeem Your Money Market Account Has Been Denied

When Henry Paulson publishes his long-awaited memoirs, the one section that will be of most interest to readers, will be the former Goldmanite and Secretary of the Treasury's recollection of what, in his opinion, was the most unpredictable and dire consequence of letting Lehman fail (letting his former employer become the number one undisputed Fixed Income trading entity in the world was quite predictable... plus we doubt it will be a major topic of discussion in Hank's book). We would venture to guess that the Reserve money market fund breaking the buck will be at the very top of the list, as the ensuing "run on the electronic bank" was precisely the 21st century equivalent of what happened to banks in physical form, during the early days of the Geat Depression. Had the lack of confidence in the system persisted for a few more hours, the entire financial world would have likely collapsed, as was so vividly recalled by Rep. Paul Kanjorski, once a barrage of electronic cash withdrawal requests depleted this primary spoke of the entire shadow economy. Ironically, money market funds are supposed to be the stalwart of safety and security among the plethora of global investment alternatives: one need only to look at their returns to see what the presumed composition of their investments is. A case in point, Fidelity's $137 billion Cash Reserves fund has a return of 0.61% YTD, truly nothing to write home about, and a return that would have been easily beaten putting one's money in Treasury Bonds. This is not surprising, as the primary purpose of money markets is to provide virtually instantaneous access to a portfolio of practically risk-free investment alternatives: a typical investor in a money market seeks minute investment risk, no volatility, and instantaneous liquidity, or *redeemability*. These are the three pillars upon which the entire $3.3 trillion money market industry is based.

Yet new regulations proposed by the administration, and specifically by the ever-incompetent Securities and Exchange Commission, seek to pull one of these three core pillars from the foundation of the entire money market industry, by changing the primary assumptions of the key Money Market Rule 2a-7. A key proposal in the overhaul of money market regulation suggests that money market fund managers will have the option to "**suspend redemptions to allow for the orderly liquidation of fund assets.**" You read that right: this does not refer to the charter of procyclical, leveraged, risk-ridden, transsexual (allegedly) portfolio manager-infested hedge funds like SAC, Citadel, Glenview or even Bridgewater (which in light of ADIA's latest batch of problems, may well be wishing this was in fact the case), but the heart of heretofore assumed safest and most liquid of investment options: Money Market funds, which account for nearly 40% of all investment company assets. The next time there is a market crash, and you try to withdraw what you thought was "absolutely" safe money, a back office person will get back to you saying, "**Sorry - your money is now frozen. Bank runs have become illegal.**" This is precisely the regulation now proposed by the administration. In essence, the entire US capital market is now a hedge fund, where even presumably the safest investment tranche can be locked out from within your control when the ubiquitous "extraordinary circumstances" arise. The second the game of constant offer-lifting ends, and money markets are exposed for the ponzi investment proxies they are, courtesy of their massive holdings of Treasury Bills, Reverse Repos, Commercial Paper, Agency Paper, CD, finance company MTNs and, of course, other money markets, and you decide to take your money out, well - sorry, you are out of luck. It's the law.

A brief primer on money markets

A very succinct explanation of what money markets are was provided by none other than SEC's Luis Aguilar on June 24, 2009, when he was presenting the case for making even the possibility of money market runs a thing of the past. To wit:

Money market funds were founded nearly 40 years ago. And, as is well known, one of the hallmarks of money market funds is their ability to maintain a stable net asset value — typically at a dollar per share.

In the time they have been around, money market funds have grown enormously — from $180 billion in 1983 (when Rule 2a-7 was first adopted), to $1.4 trillion at the end of 1998, to approximately $3.8 trillion at the end of 2008, just ten years later. *The Release in front of us sets* *forth a number of informative statistics but a few that are of particular interest are the following:* ***today, money market funds account for approximately 39% of all investment company assets; about 80% of all U.S. companies use money market funds in managing their cash balances; and about 20% of the cash balances of all U.S. households are held in money market funds.*** *Clearly, money market funds have become part of the fabric by which families, and companies manage their financial affairs.*

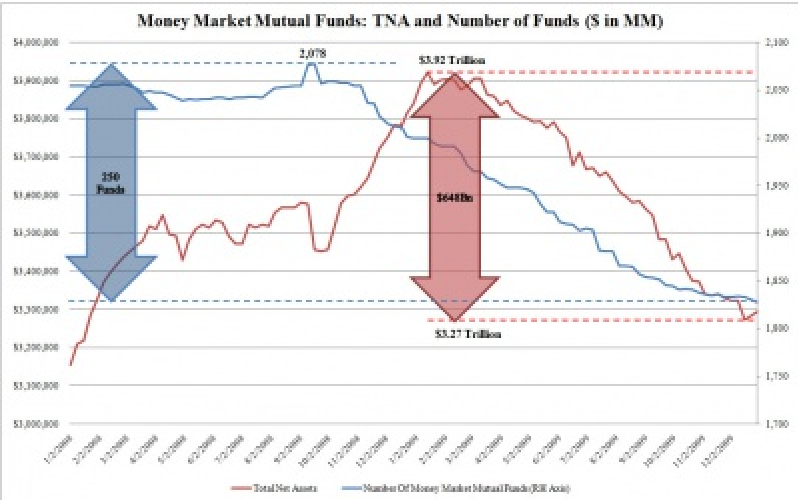
When the Reserve fund broke the buck, and it seemed like an all-out rout of money markets was inevitable, the result would have been a virtual elimination of capital access by everyone: from households to companies. This reverberated for months, as the also presumably extremely safe Commercial Paper market was the next to freeze up, side by side with all traditional forms of credit. Only after the Fed stepped in an guaranteed money markets, and turned on the liquidity stabilization first, then quantitative easing spigot second, did things go back to some sort of new normal. However, it is only a matter of time before the patchwork of band aids holding the dam together is once again exposed, and a new, stronger and, well, "improved" run on the electronic bank materializes. It is precisely this contingency that the SEC and the administration are preparing for by "empowering money market fund boards of directors to suspend redemptions in extraordinary circumstances to protect the interests of fund shareholders."

A little more on money markets:

Money market funds seek to limit exposure to losses due to credit, market, and liquidity risks. Money market funds, in the United States, are regulated by the Securities and Exchange Commission's (SEC) Investment Company Act of 1940. Rule 2a-7 of the act restricts investments in money market funds by quality, maturity and diversity. ***Under this act, a money fund mainly buys the highest rated debt, which matures in under 13 months. The portfolio must maintain a weighted average maturity (WAM) of 90 days or less and not invest more than 5% in any one issuer, except for government securities and repurchase agreements****.*

Ironically, the proposed change to Rule 2a-7 seeks to make dramatic changes to the composition of MMs: from 90 days, the WAM would get shortened to 60 days. And this is occurring at a time when the government is desperately seeking to find ways of extending maturities and durations of short-term debt instruments: by reverse rolling the $3.2 trillion industry, the impetus will be *precisely the reverse of what should be happening*, as more ultra-short maturity instruments are horded up, leaving a dead zone in the 60-90 day maturity window. Some other proposed changes to 2a-7 include "prohibiting the funds from investing in Second Tier securities, as defined in Rule 2a-7. Eligible securities would be redefined as securities receiving only the highest, rather than the highest two, short-term debt ratings from a requisite nationally recognized securities rating organization. Further, money market funds would be permitted to acquire long-term unrated securities only if they have received long-term ratings in the highest two, rather than the highest three, ratings categories." In other words, let's make them so safe, that when the time comes, nobody will have access to them. Brilliant.

The utility of money market funds has long been questioned by such systemically-embedded financial luminaries as Paul Volcker (more on this in a minute). After all, what are money markets if merely an easy, **and 401(k)-eligible option** to not invest in equity or bonds, but in "paper" which is cash in all but name (maybe not so much after the proposed Rule change passes). And as money markets account for a huge portion of the $11 trillion of mutual fund assets as of November (per ICI, whose opinion, incidentally, was instrumental in shaping future money market policy), $3.3 trillion to be precise, and second only to stock funds at $4.8 trillion, one can see why an administration, hell bent on recreating a stock-price bubble, would do all it can to make money markets extremely unattractive. In fact, the current administration has been on a roll on this regard: i) keeping money market rates at record lows, ii) removing money market fund guarantees and iii) and even allowing reverse repos to use money markets as sources of liquidity (because we all know that the collateral behind the banks shadow banking arrangement with the Fed are literally crap; as we have noted before, we will continue claiming this until the Fed disproves us by opening up their books for full inspection. *Until then, yes, the Fed has lent out hundreds of billions against bankrupt company equity, as we have pointed out in the past*). Money Markets are the easiest recourse that idiotic class of Americans known as "savers" has to give the big bank oligarchs, the Fed and the bubble-inflating Administration the middle finger. As you will recall, [recently Arianna Huffington has been soliciting all Americans do just that](): to move their money out of the tentacles of the TBTFs. In essence, the money market optionality is precisely the equivalent of moving physical money from TBTFs to community banks in the "shadow economy." Because where there is $3.3 trillion out of $11, there could easily be $11 trillion out of $11, which would destroy the whole concept of Fed-spearheaded asset-price inflation, and would destroy overnight the TBTFs, as equities would once again find their fair value. It is no surprise then, that the current financial system, and its political cronies loathe the concept of Money Markets, and have done all they could to make them as unattractive as possible. Below is a chart of the Net Assets held by all US money market funds and the number of money market mutual funds since January 2008:



Obviously, attempts to push capital out of MMs have succeeded: after peaking at $3.9 trillion, currently money markets hold a two year low of $3.27 trillion. Furthermore, the number of actual money market fund operations has been substantially hit: from 2,078 in the days after the Lehman implosion, this is now down to 1,828, a 12% reduction. At this rate soon there won't be all that many money market funds to chose from. While the AUM reduction is explicable through the previously mentioned three factors, the actual reduction in number of funds is on the surface not quite a straightforward, and will likely be the topic a future Zero Hedge post. Although, the impetus of managing money when one can return at most 0.6% annually, and charge fees on this "return" may be missing - the answer may be far simpler than we think. Why run a money market, when the Fed will be happy to issue you a bank charter, and you can collect much more, risk free, courtesy of the vertical yield curve.

Yet what is strange is that even with all the adverse consequences of holding cash in Money Markets, the total AUM of this "safest" investment option is still substantial, at nearly $3.3 trillion as of December 30, a big decline yes, but a decline that should have been much greater considering even the president since March 3 has been beckoning his daily viewership to invest in cheap stocks courtesy of low "profit and earning ratios" (that, and the specter of President's Working Group on Financial Markets). Could this action, whereby investors will no longer have access to money that historically has been sacrosanct and reachable and disposable on a moment's notice, be the last nail in the coffin of money markets? We believe so, however, we are not sure if it will attain the desired effect. With an aging baby boomer population, which would rather burn their money than invest in the stock market again and relive the roller-coaster days of late 2008 and early 2009, the plan may well backfire, and result in even more money leaving the shadow system and entering such tangible objects as deposit accounts (at community banks, of course), mattresses and socks. And speaking of the President's Working Group...

The Group of Thirty

When discussing the shadow economy, it is only fitting to discuss the shadow decision-makers. In this regard, the Group of 30, is to the traditional economic decision-making process as the President's Working Group is to capital markets. Taken from the website, the self-description reads innocently enough:

***The Group of Thirty**, established in 1978, is a private, nonprofit, international body composed of **very senior** representatives of the private and public sectors and academia. It aims to deepen understanding of international economic and financial issues, to explore the international repercussions of decisions taken in the public and private sectors, and to examine the choices available to market practitioners and policymakers.*

The Group's members meet in plenary sessions twice a year with select guests to discuss important economic, financial and policy developments. They reach out to a wider audience in seminars and symposia. Of most importance to our membership and supporters is the annual International Banking Seminar.

Sounds like any old D.C.-based think tank... until one looks at the roster of members:

- **Paul A. Volcker,** Chairman of the Board of Trustees, Group of Thirty, Former Chairman, Board of Governors of the Federal Reserve System
- **Jacob A. Frenkel,** Chairman, Group of Thirty, Vice Chairman, American International Group, Former Governor, Bank of Israel
- **Jean-Claude Trichet,** President, European Central Bank, Former Governor, Banque de France
- **Zhou Xiaochuan,** Governor, People's Bank of China, Former President, China Construction Bank, Former Asst. Minister of Foreign Trade
- **Yutaka Yamaguchi,** Former Deputy Governor, Bank of Japan, Former Chairman, Euro Currency Standing Commission
- **William McDonough**, Vice Chairman and Special Advisor to the Chairman, Merrill Lynch, Former Chairman, Public Company Accounting Oversight Board, Former President, Federal Reserve Bank of New York
- **Richard A. Debs,** Advisory Director, Morgan Stanley, Former President, Morgan Stanley International, Former COO, Federal Reserve Bank of New York
- **Abdulatif Al-Hamad,** Chairman, Arab Fund for Economic and Social Development, Former Minister of Finance and Minister of Planning, Kuwait
- **William R. Rhodes,** Senior Vice Chairman, Citigroup, Chairman, President and CEO, Citicorp and Citibank
- **Ernest Stern,** Partner and Senior Advisor, The Rohatyn Group, Former Managing Director, JPMorgan Chase, Former Managing Director, World Bank
- **Jaime Caruana,** Financial Counsellor, International Monetary Fund, Former Governor, Banco de España, Former Chairman, Basel Committee on Banking Supervision
- **E. Gerald Corrigan,** Managing Director, Goldman Sachs Group, Inc., Former President, Federal Reserve Bank of New York
- **Andrew D. Crockett,** President, JPMorgan Chase International, Former General Manager, Bank for International Settlements
- **Guillermo de la Dehesa Romero,** Director and Member of the Executive Committee, Grupo Santander, Former Deputy Managing Director, Banco de España, Former Secretary of State, Ministry of Economy and Finance, Spain
- **Mario Draghi,** Governor, Banca d'Italia, Chairman, Financial Stability Forum, Member of the Governing and General Councils, European Central Bank, Former Vice Chairman and Managing Director, Goldman Sachs International
- **Martin Feldstein,** Professor of Economics, Harvard University, President Emeritus, National Bureau of Economic Research, Former Chairman, Council of Economic Advisers

- **Roger W. Ferguson, Jr.,** Chief Executive, TIAA-CREF, Former Chairman, Swiss Re America Holding Corporation, Former Vice Chairman, Board of Governors of the Federal Reserve System
- **Stanley Fischer,** Governor, Bank of Israel, Former First Managing Director, International Monetary Fund
- **Philipp Hildebrand,** Vice Chairman of the Governing Board, Swiss National Bank, Former Partner, Moore Capital Management
- **Paul Krugman,** Professor of Economics, Woodrow Wilson School, Princeton University, Former Member, Council of Economic Advisors
- **Kenneth Rogoff,** Thomas D. Cabot Professor of Public Policy and Economics, Harvard University, Former Chief Economist and Director of Research, IMF

and, of course:

- **Timothy F. Geithner,** President and Chief Executive Officer, Federal Reserve Bank of New York, Former U.S. Undersecretary of Treasury for International Affairs
- **Lawrence Summers,** Charles W. Eliot University Professor, Harvard University, Former President, Harvard University, Former U.S. Secretary of the Treasury

and many more. Given the choice of being a fly on the wall at a G7 meeting or that of the "Group of 30", we would be very curious to see who would pick the former over the latter. These are the people, whose "reports" and groupthink determines the financial fate of the world: their vested interest in perpetuating the status quo is second to none. Which is why we read with great interest a recent paper from the Group of 30: Financial Reform, A Framework for Financial Stability, released on January 15, 2009, deep in the heart of the crisis. While the paper has enough insight for many, non-related posts (we are already working on several), we will focus on the policy recommendations presented for money market funds.

Money Market Mutual Funds and Supervision

Recommendation 3:

a. Money market mutual funds wishing to continue to offer bank-like services, such as transaction account services, withdrawals on demand at par, and assurances of maintaining a stable net asset value (NAV) at par ***should be required to reorganize as special-purpose banks, with appropriate prudential regulation and supervision, government insurance, and access to central bank lender-of-last-resort facilities.***

b. Those institutions remaining as money market mutual funds ***should only offer a conservative investment option with modest upside potential at relatively low risk.*** *The vehicles should be clearly differentiated from federally insured instruments offered by banks, such as money market deposit funds,* ***with no explicit or implicit assurances to investors that funds can be withdrawn on demand at a stable NAV.*** *Money market mutual funds should not be permitted to use amortized cost pricing, with the implication that they carry a fluctuating NAV rather than one that is pegged at US$1.00 per share.*

The phrasing of "**with no explicit or implicit assurances to investors that funds can be withdrawn on demand at a stable NAV**" should be sufficient to whiten the hairs of every proponent of money markets as a "safe" investment alternative. Yet what the SEC has done, is to take the Group of 30 recommendation, and take it to the next level: not only will funds not have explicit assurance of any kind vis-a-vis funding, but in fact, the redemption of said funds would be legally barred upon "extraordinary circumstances."

Rule 22e-3

From the SEC:

Proposed rule 22e–3(a) would permit a money market fund to suspend redemptions if: ***(I) The fund's current price per share, calculated pursuant to rule 2a–7(c), is less than the fund's stable net asset value per share; (II) its board of directors, including a majority of directors who are not*** *interested persons, approves the liquidation of the fund; and (III)* ***the fund, prior to suspending redemptions, notifies the Commission of its decision to liquidate and suspend redemptions, by electronic mail directed to the attention of our Director of the Division of Investment Management or the Director's designee.*** *These proposed conditions are intended to ensure that any suspension of redemptions will be consistent with the underlying policies of section 22(e).* ***We understand that suspending redemptions may impose hardships on investors who rely on their ability to redeem shares.*** *Accordingly, our proposal is limited to permitting suspension of this statutory protection only in extraordinary circumstances.* ***Thus, the proposed conditions, which are similar to those of the temporary rule, are designed to limit the availability of the rule to circumstances that present a significant risk of a run on the fund.*** *Moreover, the exemption would require action of the fund board (including the independent directors), which would be acting in its capacity as a fiduciary. The proposed rule contains an additional provision that would* ***permit us to take steps to protect investors****. Specifically, the proposed rule would permit us to rescind or modify the relief provided by the rule (and thus require the fund to resume honoring redemptions) if, for example, a liquidating fund has not devised, or is not properly executing, a plan of liquidation that protects fund shareholders. Under this provision, the Commission may modify the relief ''after appropriate notice and opportunity for hearing,'' in accordance with section 40 of the Act.*

Lots of keywords there: "fiduciary", "impose hardships" but most notably "permit us to take steps to protect investors." Uh, SEC, no thanks. We can protect ourselves. Your protection so far has resulted in the Madoff scandal, the BofA fiasco, billions in insider trading profits and not one guilty person, who did not manage to escape unscathed with merely a wrist slap in the form of some pathetic fine. With all due respect, SEC, any proposal that involves you acting to "protect" us should be immediately banned and any further discussion ended.

Especially in this case: what the SEC is proposing is simple - the entire market structure has been converted to a hedge fund. When investors hear the word "suspend redemptions" they envisioned a battered, pro-cyclical, leveraged, permabullish hedge fund, that suddenly "found itself" down 30, 40, 50 or more percent, and to avoid instantaneous liquidation, had to bar redemptions. Forgive us, but is the SEC confirming that the entire market is now one big casino, one big government subsidized hedge fund, where as long as things go up, all is good, but the second things take a leg down, just like any ponzi, nobody will be allowed to pull their money? Maybe Madoff should have created the same redemption suspension: his fund would still be alive and thriving, now that the government has become the biggest ponzi conductor of all time. And nobody would have been the wiser. But instead, the Securities and Exchange Commission, in discussions with the Group of 30, Barney Frank, and any other conflicted individuals who only care about protecting their own money for one more year, has decided, in its infinite wisdom, to make money markets a complete scam. And this is the gist of regulatory reform in America.

Conclusion

At this point it is without doubt that even the government understands that when things turn sour, and they will, the run on the bank will be unavoidable: their solution - prevent money from being dispensed, when that moment comes. The thing about crises, be they liquidity, solvency, or plain-vanilla, is that "price discovery" occurs all at once, and at the very same time. And all too often, investors "discover" they were lied to, as the emperor, in any fiat system, always has no clothes. Just like in September 2008, when the banks were forced to look at each-others' balance sheet and realize that there are no real assets on the left backing up the liabilities on the right, so the moment of enlightenment occurs are the most importune time: just ask Hank Paulson. Had he known his action of beefing up Goldman's FICC trading axes would have resulted in the "Ice-Nine'ing" (to borrow a Mark Pittman term) of money markets, who knows- maybe Lehman would have still been alive. Perhaps risking the cash access of 20% of US households and 80% of companies was not worth the few extra zeroes in Goldman's EPS. But we will never know. What we will know, is that now i) the government is all too aware that the market has become one huge ponzi, and that all investment vehicles, even the safest ones, are subject to bank runs, and ii) that said bank runs, will occur. It is only a matter of time. And just as the president told everyone directly to buy the market on March 3, so the SEC, the Group of 30, and Barney Frank are telling us all, much less directly, to get the hell out of Dodge. Alternatively, the game of "last fool in", holding the burning hot potato, can continue indefinitely, until such time as the marginal utility of each and every dollar printed by Ben Bernanke is zero.