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SECTION: NEWS & ANALYSIS; Financial Services**LENGTH:** 1335 words**HEADLINE:** SEC Fight Against Big Money Enters Darkness: Street Whispers**BYLINE:** Antoine Gara**BODY:**

NEW YORK (TheStreet) -- It's been a rough summer for **Securities and Exchange Commission** chairwoman Mary Schapiro. Her fight to shine light on some shadowy corners of Wall Street that failed ordinary investors during the financial crisis and in subsequent years has descended into a darkness befitting the secretive world of dark pools and big money trading. In separate moves to bring more transparency to stock trading and money market funds, the SEC's efforts have been overwhelmed and undermined by the opacity of the existing structure. The results indicate that the SEC and by proxy, investors, face a chicken and egg conundrum as they try to make stock markets and money market funds -- a major source of liquidity for markets -- more reliable in response to failures that highlighted the vulnerable structure of funds and fragility of trading networks. Schapiro may be better served responding to setbacks in the fight against market darkness with Batman-like action over Bruce Wayne-like despondency.

In spite of the SEC's failed efforts, post-crisis financial sector rules signal that attempts at reform aren't dead. In fact, they're a major test of whether SEC-inspired regulations like Dodd-Frank have any lasting bite. This week, Schapiro was forced to punt on a four-year effort to rewrite the rules on the \$2.6 trillion money market fund industry, primarily by requiring more accurate calculation of funds' net asset values, new rules on capital to buffer against losses, and restrictions on shareholder redemption practices. Schapiro's money fund industry rethink came after the **Reserve Primary Fund** "broke the buck" in September 2008, when its holding of Lehman Brothers bonds caused the fund's \$62.5 billion in assets to fall below \$1 a share in value, leading to investor losses. After the Reserve Primary Fund "broke the buck" in the days following Lehman's demise, investors fled money markets fearing other funds at a stable \$1 a share in net asset value were actually worth far less. Among the most troubling signs of distress during the financial crisis, the investor flight ended when then-Treasury Secretary Hank Paulson guaranteed the assets of the entire industry. Meanwhile, without money market funds buying short-term debt, companies as strong as **McDonalds** and

General Electric lost a key financing mechanism for operations and payroll. Schapiro proposed forcing funds to either disclose the fair value of assets on a daily basis -- a floating net asset value, or hold capital -- 3% of total assets -- to buffer against losses. This week her efforts were thwarted by a SEC vote blocking the rule change, with dissenting voters among SEC chairs in a 3-2 split arguing that the already opaque nature of money markets and short-term investment funds are prohibitive to immediate change. Four years is lightening speed in regulatory circles. "I remain concerned that the Chairman's proposal will be a catalyst for investors moving significant dollars from the regulated, transparent money market fund market into the dark, opaque, unregulated market," said SEC Commissioner Luis Aguilar, in a statement of his dissenting vote to Schapiro's proposed industry rethink. Aguilar, the former general counsel of **Invesco**, an investment company with large money market funds, highlighted that current low interest rates would make capital buffers prohibitively expensive and the rule changes could actually push investors further into shadowy corners of finance. Apparently, there's just too much darkness to go around when it comes to the pools in which big market money is swimming, so why send investors from one opaque structure to another that might be more opaque still? Earlier in August, another SEC proposal, a change to stock trading that could help bring loosely regulated dark pools and high frequency traders to more regulated exchanges, was overwhelmed by the existing opacity of markets. The SEC proposal came after nearly a decade of market share losses by exchanges like **NYSE Euronext** and **Nasdaq** to more opaque high frequency trading venues, algorithmic trading breeding grounds that were implicated in the May 2010 "Flash Crash" and multiple instances of subsequent abnormal stock trading. In July, the SEC approved its Retail Liquidity Program to fight the continued rise of dark pools by allowing the NYSE to open its own dark pool trading venue to popular electronic brokerages like **E-Trade**, **TD Ameritrade** and **Charles Schwab**. To catastrophic results, the program's first trading led to a \$440 million loss at **Knight Capital** which in a flash put that company on life support. NYSE Euronext launched the RLP in August with what it argues are investor protections of public data feeds and increased regulation. In a lobbying effort for the RLP, Duncan Niederauer, the chief executive of NYSE Euronext took to the **Financial Times** to note that the program would return stock trading from opaque outfits to more trustworthy exchanges, citing figures like the 50 dark pool exchanges across the U.S. and the 40% of overall market trading that is channeled to them. However, amid Knight's trading loss, competing RLP programs from **BATS Global Markets** -- a more opaque trading venue to the "Big Board" -- and the expected launch of other similar programs from other dark pools like **Direct Edge**, signal an industry-wide effort to block the SEC efforts to shine a light on high-frequency stock trading. The industry, it appears, is upset by the SEC's perceived favoritism of more regulated exchanges like NYSE over their off-exchange trading venues scattered across the U.S. and in nanosecond fast trading hamlets like Kansas City and Weekawken, N.J. Efforts like BATS' RLP and the expectation of similar moves by other venues imply a strategy to fight darkness with extra darkness in stock market trading, undermining what was one of the SEC's few tangible solutions to the "Flash Crash" after over two years of study. So where does this leave the SEC and its chairwoman? Clearly dispirited. In a **New York Times** interview, Schapiro called the stalled money market reform a "tragedy" for investors. Tragedy implies a bitter end, though, and one would hope the SEC's failure at reform may yet be a test of newly created market regulations that respond to the financial crisis. In the case of money markets, "The industry may have won a battle, but the war isn't over," concedes Niels Holch of advocacy group the Coalition of Mutual Fund Investors in an email to **TheStreet**. Now the **Federal Reserve's** Financial Stability Oversight Council will have the ability to peer into money markets and propose new regulations. "Ironically, the industry may face even more draconian solutions proposed by these agencies," says Holch. And there is reason to believe that in the case of money markets, the opacity of markets doesn't preclude change. "[My] guess is that investors would not have fled [money market] funds, but that fund groups would have been squeezed -- maybe imposing fees/conditions driving investors away," wrote Alan R. Palmiter, a professor at Wake Forest's School of Law and mutual fund expert, in an email to **TheStreet**. Though he added of the stalled SEC deliberations: "Somebody's gotta fund insurance and the industry says the returns are too low for investors to do it and the margins too thin for the fund groups. Check, checkmate." With stock trading venues, the Federal Reserve could also use its newly expanded Dodd-Frank reform powers to increase its oversight of high-frequency trading and dark pools. For Schapiro, whose reform efforts have gone dark, using recent failures as a motivation to dig deeper may be the only way to find a light at the end of the tunnel. For more on money market fund risks, see why the Federal Reserve's recent liquidation of bailout-era funds means **AIG's** toxic debts may be headed to a fund near you. See why 'dark pools' want faster, cheaper and dumber money to hit their order books for more on nanosecond-fast stock trading and flash crashes. -- Written by Antoine Gara in New York

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