

MEMO# 5367

November 30, 1993

FEDERAL RESERVE BOARD RESEARCH PAPER ON MONEY MARKET FUNDS

November 30, 1993 TO: BOARD OF GOVERNORS NO. 111-93 RE: FEDERAL RESERVE BOARD RESEARCH PAPER ON MONEY MARKET FUNDS

Attached is a copy of a recent paper by two economists with the Federal Reserve Board concerning the effects of the SEC's amendments to Rule 2a-7 in 1991, which tightened the limits on portfolios of taxable money market funds. While much of the paper is rather technical, some of its conclusions are highly significant. For example, the paper concludes that the riskiness of taxable money funds fell significantly after the SEC's amendments were proposed in 1990 (i.e., much of the adjustment to the new requirements occurred before the amendments were finally adopted). To offset some of the resulting decrease in yield, funds lengthened their average portfolio maturities. The paper also concludes that the amendments to Rule 2a-7 may have reduced the risk that the Federal Reserve would have to act as a "lender of last resort in a crisis involving money funds." The paper states: Had widespread runs on money funds in fact developed in 1989 and 1990, following the well-publicized defaults in the commercial paper market, the Federal Reserve might have felt considerable pressure to open its discount window to ensure adequate liquidity among money market funds faced with widespread redemptions. The amended Rule, by significantly reducing the prospects for runs on money funds therefore also lowered the probability that the Federal Reserve would ever be called on to act as a lender of last resort because of money funds. [Footnote omitted.] Matthew P. Fink President Attachment

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