

ICI VIEWPOINTS

April 4, 2012

Money Market Funds and Financial Stability: Reason and the Facts Must Guide Regulators

We are pleased to see that the [Financial Stability Oversight Council](#) continues to take a thoughtful approach on the issue of designating “systemically important financial institutions.” That’s in stark contrast to [some commentators](#), who would have regulators rush to put money market funds under that designation. As ICI has argued in a number of venues, a “SIFI” designation is inappropriate for these funds and plainly would run counter to facts and reason. Let’s review why.

Money Market Funds Have Stringent Risk-Limiting Characteristics

One key reason why the SIFI designation is not appropriate for money market funds is that these funds are among the most strictly regulated financial products offered to investors. As ICI conveyed to the Financial Stability Oversight Council (FSOC) in a [2011 letter](#), money market funds must comply with the comprehensive requirements of the Investment Company Act—plus an additional set of regulatory requirements specific to these funds.

These legal requirements, [recently strengthened by the Securities and Exchange Commission in 2010](#), include tough standards on credit quality, liquidity, maturity, and diversification. The basic objective here is to limit a fund’s exposure to credit risk, interest rate risk, liquidity risk, and the risk that big shareholders may suddenly exit a fund.

Industry-wide Reforms Have Proven Remarkably Effective

Critics of money market funds frequently fail to recognize the 2010 SEC updates—and their success. As [I’ve discussed recently](#), money market funds, under these enhanced regulatory requirements, have weathered three severe challenges: the European sovereign debt crisis, the impasse over the U.S. federal debt ceiling, and the historic downgrade of the U.S. debt rating—all while enduring the long-running punishment of near-zero interest rates.

These challenges prompted investor movement out of money market funds; last summer’s outflows were significant. Yet money market funds easily met these redemptions because the funds held liquidity that met and exceeded the standards set by the 2010 reforms.

This industry-wide approach makes far more sense than designating hundreds of money market funds—or even just prime money market funds—offered in the U.S. market as SIFIs, thus subjecting each to inappropriate, bank-like prudential standards applied by the Federal Reserve Board.

Money Market Funds are Not “Shadow Banks”

In a recent [editorial](#), Bloomberg View addressed these matters by, unfortunately, perpetuating the misperception that money market funds are “shadow banks.” In [comment letters](#) and elsewhere, we’ve confronted this misperception. I commend readers to a [December ICI Viewpoints post](#) by ICI Chief Economist Brian Reid, who succinctly reviews why it’s wrong to assume that all investing and lending that occurs outside the banking system is somehow shadowy or inappropriate. Namely:

- Banking and capital markets are both highly regulated and have successfully coexisted for centuries.
- Robust capital markets add resiliency to the financial system, because the capital markets sometimes weather times of crisis better than banks.
- Moving more financial activity into the banking system will concentrate risks and make the financial system more vulnerable.

Bloomberg’s editorial urges FSOC to err on the side of “[sweeping] up more firms than it expected to have to oversee.” We urge the FSOC to err on the side of reason and the facts.

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