

ICI VIEWPOINTS

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Take One Idea Off the Table: Forcing Money Market Funds to Float

The Investment Company Institute would like to thank the Wall Street Journal for its balanced approach in analyzing the debate over money market fund regulation—providing countervailing views from [Yale University Professor Jonathan Macey](#) and [Columbia Law School Professor Jeffery Gordon](#) about how to make money market funds even more resilient in the face of the next financial crisis.

As Professor Macey points out, money market funds have an outstanding record of protecting their investors' assets through even the worst markets, thanks to a robust framework of risk-limiting regulations. When cascading bank failures shook money market funds in September 2008, ICI and its members led the way in strengthening that framework. Our funds voluntarily adopted higher credit standards, shorter portfolio maturities, and new liquidity requirements—even before the Securities and Exchange Commission adopted [new rules](#). For example, under today's liquidity standards, prime money market funds must hold \$490 billion in assets that can be turned into cash within five business days—a direct response to the market-wide freeze of September 2008.

As regulators call for further structural changes, our industry continues to lead the way. We've considered all the ideas addressed in the authors' articles, and more. We remain open to a wide range of proposals.

One principle, however, is key: any further changes must preserve the crucial value of money market funds for investors and the American economy. As Treasury Secretary Timothy Geithner said in early May, regulators must “figure out how to bring a little bit more resilience into that system without depriving the economy of the broader benefits that those funds provide.”

One idea clearly fails that test. Forcing money market funds to abandon their stable \$1.00 share price—also known as “floating the NAV”—would do nothing to reduce risks, but would destroy the investor and economic value of these funds.

Professor Gordon says that investors wouldn't “react wildly” in adverse markets if they grew accustomed to seeing their money market fund's price fluctuate. There are two problems with that view. First, a money market fund's market value rarely budes: as [ICI research](#) shows, during the decade from 2000 to 2010, the average market value for prime funds never fell below \$0.9990 (i.e., one-tenth of one cent below \$1.00) until September 2008, when the average price briefly hit \$0.9980 (two-tenths of one cent below \$1.00).

Shadow Prices, January 2000–April 2010

Sample of prime money market funds, weekly

Source: Investment Company Institute

Second, in the case of floating funds, familiarity does not breed indifference. Just ask the investors in floating-value ultra-short bond funds—which are similar to money market funds but don't have the same regulation and feature a floating NAV—who pulled out 60 percent of their assets when the funds' values dropped in 2008. From those funds' experience, it's clear that even investors who are accustomed to routine fluctuations will not sit tight in a black-swan market. And, as Professor Macey notes, forcing money market funds to float will drive much of their \$2.7 trillion in assets into alternatives that pose greater risks to the financial system and taxpayers.

While the benefits of floating funds are illusory, the costs would be enormous. Legions of investors, including businesses and institutions that are required by law or policy to hold cash in stable-value accounts, would abandon money market funds. Retail investors will also flee, because they want same-day access to their assets that floating-value funds can't provide—and don't want to turn every transaction with their fund into a taxable event.

That flight from floating funds would severely disrupt the financing that money market funds provide to America's businesses, consumers, and state and local governments—the lifeblood of the economy. Money market funds hold more than one-third of the commercial paper that finances payrolls and inventories. They are substantial holders of the asset-backed commercial paper that underlies credit card, home equity, and auto lending. And these funds hold more than half of the short-term municipal debt that finances state and local governments for public projects, from bridges to hospitals.

Little wonder that key economic players from across the private and public sector—from the National Association of Corporate Treasurers to the National League of Cities to the Consumer Federation of America—have roundly rejected proposals that would undermine money market funds' stable \$1.00 share price.

During the brief federal guarantee program put into place in 2008, taxpayers collected \$1.2 billion in fees from money market funds without paying a dime in claims. The fund industry is committed to finding a solution that further strengthens money market funds for the next crisis and that makes government support or intervention unnecessary. But any structural change must preserve the vital investor and economic role that money market funds play.

(Note: You can find more information on money market funds' value to investors and the economy at the [Preserving Money Market Funds](#) website.)