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Findings Relevant to Current Money Market Fund Regulatory Developments and U.S. Debt Ceiling Policy Debates

Washington, DC, January 15, 2013 - Comprehensive reforms by the Securities and Exchange Commission (SEC) in 2010 to regulations governing money market funds were tested by market stresses in 2011 and are working, according to new analysis by the Investment Company Institute (ICI) in a study released today.

The study, *Money Market Mutual Funds, Risk, and Financial Stability in the Wake of the 2010 Reforms*, further finds that those reforms ultimately enhanced financial stability—as evidenced by the fact that the prime money market had enough liquidity to meet heavy redemptions in the summer of 2011, triggered by two major market events. At the beginning of that summer, thanks to the SEC 2010 reforms, prime money market funds were already poised to manage through the market stresses with higher liquidity and increased transparency. Those factors, coupled with diligent portfolio management, allowed funds to respond to evolving market conditions.

Study Informs Regulatory Debate in Face of Potential New Market Stresses

The study examines the impact on money market funds of the SEC 2010 reforms, which significantly strengthened the maturity, credit risk, and liquidity requirements for money market fund holdings. The study comes as the Financial Stability Oversight Council (FSOC) considers additional changes to money market fund regulation and as Congress and the Administration engage in policy debates over the looming U.S. debt ceiling, which could be a catalyst for new stresses in the financial markets.

"The study confirms that money market funds of 2013 are nothing like the funds of 2008, thanks to the SEC's far-reaching amendments to money fund regulation," said ICI President and CEO Paul Schott Stevens. “This is important analysis and perspective for regulators to consider as they look at additional regulations and for the public to understand, as the nation faces another debt ceiling debate in the coming weeks. Money market funds are stronger and well positioned today to deal with market issues.”

Analysis of 2011 Market Stresses: Money Market Funds Reacted Carefully and Proactively, and Were Well Positioned to Manage Events

Money market funds were hit in the summer of 2011 by two financial market shocks: the standoff over the U.S. federal debt ceiling and deteriorating conditions in eurozone debt markets. The study finds that money market fund managers reacted appropriately to both events and money funds were well positioned to manage the events due to new requirements in place.

- Money market fund managers prepared for the likelihood that the U.S. federal government would default in 2011. Anticipating that concerns about the debt ceiling impasse might lead investors to redeem shares, both government and prime funds shortened their maturities in the weeks leading up to a key August 2011 deadline. Funds also maintained levels of liquidity well above new liquidity requirements.
- Money market funds gradually reduced their holdings to banks most exposed to the unfolding debt crisis in Europe. Money market funds also showed a careful and proactive response to the unfolding sovereign debt crisis in Europe during the 2011 market turmoil. Managers reduced their overall holdings of securities issued by banks in the eurozone from 30 percent of their assets in May 2011 to 11 percent by December 2011. In addition, the evidence shows that prime funds also reduced their exposures to other European banks that, although outside of the eurozone itself, were exposed to eurozone banks.
- Evidence from 2011 shows that prime money market funds took only marginally more credit risk than did Treasury-only money market funds.

ICI analyzed data on credit default swap spreads in 2011, and found that prime money market funds took on or maintained only minimal credit risk, despite small increases in such risk as the eurozone crisis progressed in the second half of 2011.

The paper concludes: “The efficacy of the SEC’s new provisions was tested in 2011 by the market turmoil created by the standoff over the U.S. federal debt ceiling and deteriorating conditions in eurozone debt markets. Money market funds passed these tests. The data show that money market fund managers proved themselves careful stewards of their investors’ assets, adjusting their holdings in response to changing conditions and maintaining liquidity levels above those stipulated by the 2010 requirements.”

ICI Research Debunks Misperceptions About Money Market Funds’ Impact on the Financial System During 2011 Market Stresses

The ICI study rebuts a number of oft-repeated misperceptions about the role of money market funds during the 2011 financial market shocks. Specifically, the evidence supports the conclusion that money market funds’ proactive measures to reduce their credit and market risk during the market difficulties in 2011 did not harm the financial system. Relevant findings in the study, based on 2011 data, include:

- Claims that money market funds “squeezed” European bank funding in 2011 are misleading or overstated. Prime money market funds did reduce their dollar holdings of eurozone banks, but these reductions were merely a small part of a months-long, market-wide withdrawal from eurozone banks that reflected deteriorating financial conditions and rising credit concerns in Europe. The fact that eurozone banks did not tap European Central Bank dollar swap lines earlier in 2011, and for larger amounts, suggests that they were able to adapt to the reduction in funding from money market funds.

- Outflows from prime money market funds did not cause an aggregate decline in lending by subsidiaries of foreign banks in the United States. Recent research by some regulators could be interpreted as suggesting that U.S. subsidiaries of foreign banks reduced lending to U.S. entities in 2011 because of a reduction in funding from money market funds in the second half of 2011. U.S. subsidiaries of foreign banks actually increased lending to the U.S. economy in the second half of 2011.
- Outflows from prime money market funds did not cause collateral damage to U.S nonfinancial firms. Contrary to some reports, prime funds increased their lending to U.S. nonfinancial firms in the summer of 2011. The prime funds most exposed to eurozone banks reduced their holdings of securities issued by U.S. nonfinancial firms over the summer of 2011 by a small amount, $900 million. More than anything, however, this decline reflected the decision of U.S. nonfinancial firms to take advantage of historically low interest rates to replace short-term funding with long-term debt issuance.

For more information about money market funds, please visit our money market fund resource center.