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Is SEC Data Misleading the Public on Sponsor Support of Money Market Funds?

By Sean Collins

In her testimony at a hearing today before the Senate Banking Committee, Securities and Exchange Commission (SEC) Chairman Schapiro made this statement.

"Based on an SEC staff review, sponsors have voluntarily provided support to money market funds on more than 300 occasions since they were first offered in the 1970s."
The SEC has not released its analysis, so we do not know precise dates or what exactly is being measured or counted. Nevertheless, we believe the estimate of 300 occasions is highly misleading.

Other Research in This Area Suggests Serious Flaws in SEC's Approach

An August 9, 2010, report by Moody's Investors Service identified 181 cases in which U.S. funds had received "support" from their sponsors over the period from 1980 to August 2009.

The bulk of these 181 instances (137 or 66 percent) occurred before the year 2000. Indeed, 60 percent of these events (108) occurred in 1994 or before. In other words, they took place either before the SEC significantly tightened the risk-limiting provisions of Rule 2a-7 in 1991 for taxable funds, or before it tightened the application of Rule 2a-7 to tax-exempt funds in 1996 and 1997.

These facts serve to highlight a key question. Why, as Chairman Schapiro's testimony suggests, did the SEC staff start its count of instances of fund sponsor support in 1971? The SEC didn't adopt Rule 2a-7 and its risk-limiting conditions until July 1983. Drawing observations from a history that reaches back to the 1970s strikes us as having no relevance to today's policy debate.

Sponsor Support Does Not Mean a Money Market Fund Is in Danger

Chairman Schapiro's testimony claims that "100 funds were bailed out by their sponsors during September 2008." Again, without having seen the SEC staff's spreadsheet, we cannot verify this figure. The Moody's study indicates that 36 U.S. registered money market funds received sponsor support during the period 2007 to August 2009.

Whatever the correct figure for the crisis period, it is important to understand why money market fund sponsors occasionally provide support and what constitutes "support." The fact that a fund sponsor provides support does not necessarily mean that the fund is in danger of breaking the dollar. Sponsors may provide support for a number of reasons, including avoiding headline risk of a particular security or securities, to maintain a AAA credit rating for a money market fund, or to respond to investors' concerns regarding their degree of comfort with particular securities.

As Chairman Schapiro indicates in her testimony, sponsor support can take many forms. From 2007 to 2009, some sponsors (especially in 2007) made outright contributions of capital or purchases of securities. In many other cases, however, sponsors provided "conditional support" agreements (such as letters of credit or guarantees) in which sponsors would agree to provide support to their funds *should losses materialize*.

Until the SEC provides the data backing its analysis, we won't know how many of these conditional support agreements ultimately required sponsors to *actually* provide support. To the extent that support did materialize, we do not know from SEC statements whether it was significant or de minimis. Finally, we do not know whether any support that materialized actually led to losses among sponsors, or whether the securities that sponsors may have supported simply matured at par without loss.

In her testimony, Chairman Schapiro suggests that money market funds continue to be supported by their sponsors. We know of only one instance since the 2010 reforms. That instance was related to Eksportfinans, a quasi-public entity established and partially owned by the Norwegian government to support exports from Norway. But the example is a red herring. It had nothing to do with the eurozone debt crisis, arising instead from a change in European banking standards. Moreover, there was no danger of funds breaking the dollar. The support was provided because a rating agency threatened to place AAA-rated money market funds that continued to hold Eksportfinans on negative credit watch. Fund sponsors reacted differently to the threat, some selling Eksportfinans in the market, others accepting a temporary negative credit watch, and at least one purchasing the securities outright from funds. To our knowledge, in all cases the securities matured at par.

We look forward to reviewing the SEC's analysis to make sure misleading statistics are not a part of the important discussion around money market funds.

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