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The NY Fed's Study: A Pretty Blueprint for an Unworkable Idea

By Paul Schott Stevens

The financial press last Friday was full of headlines like the following: [‘NY Fed Report Advocates Limiting Some Money-Market Fund Withdrawals.’](#) I had to stop and ask myself, “Why is this news?”

Anyone who's been paying attention for the last three years knows that the Fed—both the Board in Washington and regional Fed banks—has been campaigning for “structural” changes in money market funds. Unfortunately, those changes the Fed most favors—including redemption freezes that would deny investors full access to their fund balances—are precisely the changes most likely to deter investors from using money market funds. But that hasn't stopped the campaign. Nor have the likely consequences for businesses and state and local governments—money market funds are an essential source of funding for both.

The [new paper](#) published by the Federal Reserve Bank of New York is a detailed elaboration of redemption freezes—or “minimum balance at risk” (MBR), as the authors dub the idea. It has complex charts and precise calculations of the levels of MBR needed to balance investors' incentives. It has probabilities and loss functions.

It looks like a 77-page blueprint for a lead balloon.

No matter how finely it's designed, a redemption freeze won't fly. Investors use money market funds because they want stability, liquidity—access to their cash when they want it—and convenience. Redemption restrictions kill two of those three factors, and they would crush demand for money market funds.

How do we know this? Investors have told us. In [a survey of corporate treasurers and other institutional investors](#) Treasury Strategies, Inc. found that 90 percent of current money fund users would eliminate or reduce money market funds from their cash management. Based on their projected changes in usage, Treasury Strategies calculates that institutional assets would fall by 67 percent. [A survey by Fidelity Investments](#) found that half of retail investors would drop or pull back from money market funds if they faced freezes on a portion of their assets.

Equally important would be the reaction of intermediaries—brokers, retirement plans, investment advisers, and others—to the enormous operational complexities of implementing redemption holdbacks. Our [detailed study](#) of these operational implications shows that daily redemption restrictions would simply render money market funds useless for fiduciaries, such as retirement plans, trustees, and investment advisers, and for sweep programs offered by brokers and others. For other users, implementing the necessary systems for holdbacks could cost hundreds of millions of dollars—costs that no firm could justify in the face of evidence that investors will abandon funds that have holdbacks.

Put it together, and it's clear that redemption restrictions would turn money market funds into a product that no one would want to offer and no one would want to buy.

How does the New York Fed's paper deal with the fact that its balloon would never get off the ground? In short, it doesn't.

The paper doesn't address operational complexities or the appetite of intermediaries to absorb hundreds of millions of dollars in expenses. The authors just wave away any concern that investors might abandon money market funds, claiming that “the limitations of other cash management opportunities available for MMF investors” will keep investors as captives.

In reality, institutional investors will have access to unregistered funds that will be free to offer investors the same stability, liquidity, and convenience that they desire—but without the risk-limiting regulation and transparency that money market funds now provide. Ignoring that reality means ignoring the potential for the redemption freeze proposal to increase, rather than reduce, systemic risk.

As I said at the outset, there's no news here. The Fed still wants to say that money market fund investors should be the only users of a mainstream financial product who can't get full access to their assets. Dressing up redemption freezes as "MBRs" doesn't change what they truly are—mighty bad recommendations.

Paul Schott Stevens was President and CEO of ICI.

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