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A Bad Diagnosis Could Be Fatal for Money Market Funds

By Paul Schott Stevens

Bad diagnosis leads to bad prescriptions—and the errors can be fatal. The *Wall Street Journal*'s lead editorial today, "Money Fund Make-Over," falls into that trap.

The Rx of this editorial is premised on the notion that money market fund investors don't understand that they're just that—investors. Yet every fund's prospectus provides a clear description of all risks and rewards associated with the fund. No fund offers any expectation of an explicit or implicit guarantee by the fund sponsor or the U.S. government. That message is repeated in virtually every communication from money market funds to investors.

That misdiagnosis leads the idea that forcing these funds to "float" their net asset value would somehow make investors more informed and secure. But all the evidence argues otherwise. From 2000 through April 2010, through all sorts of interest rate and market environments, the average mark-to-market value of prime funds' portfolios never deviated from $1.00 by more than 20 basis points (0.2 cents). The notion that such small swings in value would make investors indifferent to a repeat of 2008—a banking crisis when investors lost confidence in the securities of all financial institutions—beggars belief. (In fact, floating-value ultra-short funds lost 60 percent of their assets in 2007 and 2008—clear evidence that floating a fund's value doesn't make it run-proof.)

Instead, forcing money market funds to float will simply drive investors out of these funds. Faced with the accounting nightmare of treating every purchase and check redemption as a taxable event, individuals and institutions will look elsewhere for the stability and convenience they want. As money market funds shrink, the economy will be hit by disruptions in financing for businesses (money market funds hold 36 percent of commercial paper), state and local governments (57 percent of short-term municipal debt), banks (21 percent of large certificates of deposit), and even the Treasury (16 percent of Treasury bills).

Making money market funds float won't eliminate investors' demand for stable-value cash. So instead of investing in a well-regulated money market fund, institutions will find stable-value cash pools that aren't regulated and don't have the same requirements for credit quality, maturity, transparency, and liquidity. Is this how the Securities and Exchange Commission and the *Journal* propose to reduce systemic risk?

The real solution for the problems money market funds faced in 2008 has already been implemented. The *Journal* editorial notes last summer's fears that funds' exposure to the European debt crisis could create incentives to run. It failed to point out that money market funds withstood that challenge—and the simultaneous risks caused by the U.S. debt ceiling standoff—without a hitch. The reason is simple: the 2010 money market reforms, enacted with the support of the industry, have made these funds more resilient and stronger in the face of crisis.

(The editorial does get one thing right—with its proposal for credit buffers and redemption freezes on investors' assets, the SEC has managed to find a combination of ideas that's actually worse than forcing money funds to float. That's quite a regulatory achievement.)

Bad diagnosis, bad medicine—and a result that could be fatal for a key component of America's financial infrastructure. I would expect the *Journal* to see right through this scheme—not to applaud it.

For more on money market funds and their role serving investors and the economy, see ICI's resource page and the Preserve Money Market Funds website.

Paul Schott Stevens was President and CEO of ICI.
