

ICI VIEWPOINTS

AUGUST 14, 2012

Correcting the Record: What Money Market Fund Investors Know

By Mike McNamee

U.S. money market funds are one of the most transparent financial products on the planet. At just about every opportunity—in advertisements, in formal disclosures, and in shareholder communications—money market funds clearly tell investors that these funds are investment products and carry no guarantees, either from the government or from fund sponsors. And money market fund investors tend to be savvy and knowledgeable about risks. After all, 65 percent of money market fund assets are held in institutional share classes.

But regulators, now campaigning for structural changes in money market funds, find it convenient to question the effectiveness of disclosure and investors' ability to recognize and manage risks. Instead, in their public statements, officials from the Federal Reserve and the Securities and Exchange Commission (SEC) portray investors as confused and misled.

To ensure that debate over money market funds is based in facts and not myths, we're checking and correcting regulators' arguments about money market funds. We're focusing primarily on SEC Chairman Mary Schapiro's [latest testimony](#) before the Senate Banking Committee, including this statement:

Misstatement: "Recurrent sponsor support has taught investors to look beyond disclosures that these investments are not guaranteed and can lose value. As a result, when a fund breaks a dollar, investors lose confidence and rush to redeem."

It's contradictory to suggest in one sentence that investors are oblivious to risks, and then to say in the next that investors are prone to panic. But that's just one of the problems in this misstatement.

A bigger issue is that the SEC has produced no evidence to support this account of investor behavior. There's no sign in the Commission's statements or public record that the SEC has surveyed money market fund investors, gauged their attitudes, or analyzed their behavior.

Others, however, have filled that gap—and their findings lend little support to the notion that money market fund investors are ignorant of risks or believe that money market funds are guaranteed. [Surveys by Fidelity Investments](#), for example, found that 75 percent of retail investors know that the government does not guarantee money market funds, and fewer than 10 percent think the government would step in to preserve a fund's \$1.00 net asset value (NAV). Instead, four out of five investors knew that securities held by money market funds fluctuate in value, and 83 percent recognize that money market fund investments carry as much or more risk as bank accounts.

Institutional investors—corporations, state and local governments, financial firms, retirement plans, and others—are deeply informed, given the role money market funds play in their daily operations. Indeed, Nancy Kopp, treasurer of the State of Maryland, testifying at the same hearing, [chided Chairman Schapiro for treating institutional investors like "children"](#) (video, at 1:21:44 mark).

It also turns out that Chairman Schapiro's statement embodies a strong dose of revisionist history, because the SEC traditionally has defended disclosure and investors' understanding of money market funds—even when sponsor support for money market funds is at issue.

In 1996, the Commission adopted a new rule (Rule 17a-9) to permit fund sponsors to buy portfolio securities from their money market funds—normally barred as an affiliated transaction—under specified conditions. At the time, commenters (including ICI) opposed the

adoption of Rule 17a-9 because of concerns that the mere existence of such a rule would cause investors to expect a fund's adviser to buy out troubled securities from the fund, thus guaranteeing that the fund will maintain a stable NAV.

Oh, no, [responded the SEC](#)—"existing rules applicable to money funds already address this concern by requiring money fund prospectuses and sales literature to disclose prominently that there is no assurance or guarantee that a fund will be able to maintain a stable net asset value of \$1.00 per share."

That was in 1996—a long time ago. But the SEC made the same arguments in 2010, two years after the Reserve Primary Fund broke the dollar and a year after Chairman Schapiro took office. Then, it amended Rule 17a-9, making it even easier for a sponsor to offer support by buying securities out of a money market fund portfolio. At that time, [the SEC stated](#) the amendments would not "materially change shareholder's perceptions about money market funds or the likelihood of sponsor support during times of market turmoil." Rather, the SEC noted that affiliated sponsor support "transactions appear to be fair and reasonable and in the best interests of fund shareholders."

Now, the SEC wants to use alleged investor confusion about sponsor support as evidence for the notion that money market funds pose systemic risk. But the agency's earlier analysis—that investors understand the clearly disclosed risks of money market fund investing—fits the facts better.

(As for that "recurrent sponsor support"—we've already discussed [the misleading and deceptive nature of the SEC's tally of so-called sponsor support](#). That's perhaps the biggest myth of the batch.)

Misstatement: The growth of money market funds from 1990 to just before the 2008 crisis was "fueled largely by institutional investors, who were attracted to money market funds as apparently riskless investments paying yields above riskless rates."

Once again, the SEC hasn't offered any evidence to support its Chairman's conjectures about investors' behavior and beliefs. Institutional investors did indeed account for much of the growth in money market fund assets over this period—but let's look at the real reasons:

- Before the early 1990s, a much larger number of institutional investors, such as corporate cash managers, ran their own portfolios of money market securities. Over time, however, they found that money market funds were often a more efficient and less costly cash management vehicle, providing better diversification and credit and market analysis than cash managers could achieve on their own.
- For the same reasons, bank trust departments also increased their reliance on money market funds, fuelling institutional asset growth.
- Thanks to the Federal Reserve Board's Regulation Q, banks could not pay interest on business checking accounts until 2011. Cash managers who wanted to earn a market rate of interest increasingly turned to money market funds—which, by design, must pay a market rate of interest. Reg Q's impediment to paying interest on business checking accounts was removed temporarily in the Dodd-Frank Wall Street Reform and Consumer Protection Act after the financial crisis.

One last note on Chairman Schapiro's use of the phrase "yields above riskless rates" to describe a market rate of interest: market rates are higher than the "riskless rate" (usually defined as the rate on Treasury securities) because most securities are not risk-free. Neither are money market funds—a fact that's well understood by their investors.

This is the third ICI Viewpoints posting on myths and misstatements about money market funds. The previous entries:

- [Correcting the Record: The "Susceptible to Runs" Myth](#)
- [Correcting the Record: Uncovering Regulators' False Narrative of 2008](#)

Mike McNamee is ICI's chief public communications officer.