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The Facts and Principles That Must Guide Money Market Fund Reform

By Dan Waters

In Madrid this week, the board of the International Organization of Securities Commissions will choose their course of action on money market funds. Their decisions will be weighty, given the significance of these funds to the global economy, their use by tens of millions of investors, and the global debate around their regulation.

How should regulators approach reform? For the global fund industry, which also gathers this week for a conference in Brussels on money market funds, the answer is clear. Regulators must respect the facts of recent developments around money market funds. They also must hew closely to a few commonsense principles that have always served regulators well and apply them in the context of money market funds.

Let’s start with the facts. It is beyond doubt that regulators in many jurisdictions have made great strides in improving the rules governing money market funds since the financial crisis of 2007–2008. Simply put, in many places these funds are a different, and much stronger, product than they were prior to the crisis.

In Europe, the Committee of European Securities Regulators, the predecessor organization of the European Securities and Markets Authority, published guidelines in 2010 on a common definition of European money market funds to improve investor protection. The guidelines addressed the challenges faced by money market funds during the financial crisis, including standards relating to portfolio quality and maturity. For its part, the Institutional Money Market Funds Association (IMMFA) updated its Code of Practice, adopting tough new standards on fund liquidity and disclosure to which its members adhere.

In North America, Canadian regulators have approved new investment standards for money market funds, such as new daily and weekly liquidity requirements as well as new maturity restrictions. Meanwhile, the U.S. Securities and Exchange Commission (SEC) in 2010 adopted a sweeping set of similar changes designed to strengthen money market funds, and to provide greater protections for investors in a fund that finds itself unable to maintain its constant net asset value (NAV) per share.

These efforts have measurably bolstered money market funds and helped them easily weather recent market turmoil, such as the fallout from debt crises in Europe and the United States. Today, IMMFA and U.S. money market funds maintain liquidity at levels that exceed new standards. Indeed, U.S. money market funds hold liquid assets that are more than two times greater than the money market fund outflows during the chaotic week of September 15, 2008, when Lehman Brothers failed and a U.S. money market fund, buckling under the pressure of heavy investor redemptions, could not maintain its $1.00 NAV.

Even with this progress, there is global discussion about additional regulatory steps for money market funds. Reform has been uneven, and some jurisdictions may want to consider doing more. As they take action, regulators should be guided by a few simple and sensible principles.

First, proceed from solid facts. An essential first step for regulators working on this issue is to evaluate carefully the effectiveness of money market fund reforms implemented since the crisis. The fund industry stands ready to help in this effort with data and analysis.

Second, build on success. Heightened requirements for money market funds adopted in the wake of the crisis have proven their worth, but they have not been adopted broadly. Great potential exists for wider adoption, especially regarding liquidity and disclosure standards.

Third, carefully align proposals to concerns. Some reform proponents point to variable NAVs as a way to address redemption pressures like those faced by money market funds in 2008. Yet a review of that period reveals that mutual funds that float their NAVs were not immune to redemption pressure. Solutions must actually address the problem in question.

Fourth, respect local market differences. One size does not fit all in financial regulation, simply because markets differ from country to country. In some countries, for example, institutional investors may have a large presence in money market funds. In others, retail investors may play the predominant role. The rules need the flexibility to accommodate such distinctions.

Finally, preserve competition and choice for investors. Drastic proposals—such as mandating capital requirements or variable NAVs—will make money market funds costly or cumbersome for investors. Such policies could end the availability of money market funds as a convenient, diversified, conservative investment choice. Assets then would migrate either to banks, concentrating risk, or to less-regulated alternatives. That would be a bad outcome for investors, issuers, and the financial system as a whole. Regulators can best avoid that with a fact-based, principled approach to reform.

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