

MONEY MARKET FUNDS IN 2013

FSOC Fails to Provide Evidence to Back up Assertions to Justify Action on Money Market Funds

In its [January 24 comment letter](#), ICI argues that the Financial Stability Oversight Council (FSOC) fails to support its contentions that the activities and practices of money market funds could create or increase risks to the financial system.

The Council's assertions about money market funds distort the record and exaggerate the impact of money market funds on the financial crisis, and ignore the substantial benefits of the 2010 SEC reforms. FSOC's determination also is premised on the false notion that characteristics of money market funds and their investors are unique, and not common to products and participants in the short-term securities markets. (See page 14 of the comment letter for a detailed discussion of these issues)

- **FSOC fails to support its contentions.**
 - For example, FSOC contends that use of discretionary sponsor support to maintain stable net asset values (NAVs) has obscured investors' understanding of money market funds' risk and potential for loss.
 - However, FSOC has not surveyed investors, gauged their attitudes, or analyzed their behavior to support that claim.
 - In fact, FSOC ignores research and U.S. Senate testimony by money market fund investors indicating that investors are well aware of the risks associated with these funds.
 - It also ignores the fact that when adopting and expanding rules permitting sponsor support, the SEC repeatedly defended disclosure and investors' understanding of money market funds.
 - Similarly, FSOC suggests that money market fund investors are seeking to invest in securities that have no interest rate or credit risk.
 - The report, however, provides no evidence that investors believe that they are investing in a riskless security.
 - In fact, [a survey by Fidelity Investments](#) found that 81 percent of retail investors know that securities held by money market funds fluctuate up and down daily in value, and 83 percent recognize that money market funds carry as much or more risk as bank accounts.

- **FSOC's assertions about money market funds distort the record of the financial crisis of 2007–2008 , exaggerating the impact of money market funds on the financial crisis.**
 - The FSOC report contends that money market funds' extensive interconnectedness with financial firms, the financial system, and the U.S. economy can create a "significant" threat because heavy redemptions in money market funds can spill over to other entities throughout the financial system.
 - The report implicitly—but inaccurately— assumes that the market shocks originate with money market funds and then spread to other sectors.

- Actual experience from the 2007–2008 crisis shows just the opposite. Shocks occurred outside of money market funds, and the money markets and money market funds actually acted as shock absorbers to the rest of the markets.
 - ICI has analyzed the events of the financial crisis, finding—consistent with the results of the [2012 SEC Staff Study](#)—that many factors spurred redemptions from money market funds and that money market funds were not the cause of the crisis; rather, they felt the impact of the unfolding financial crisis like other market participants.
 - The events of 2008 were highly unusual. Federal Reserve Chairman Ben Bernanke characterized the events in the fall of 2008 as “the worst financial crisis in global history, including the Great Depression.”
 - During September 2008, money market fund investors, like all other investors, reacted to the rapid deterioration in banks’ financial health, the U.S. government’s unpredictable responses to financial institutions’ collapses, and concerns about whether in such an environment, prime money market funds could continue to sell assets into a frozen commercial paper market.
 - Pressures in the commercial paper and other short-term markets were driven by the rapid retreat of a wide range of investors, not just money market funds. Because of their transparency and regulatory oversight, however, money market funds were simply the most visible and easily observable market participants.
 - There is evidence that a variety of market participants were pulling back their exposures to financial institutions, particularly banks, during the fall of 2008.
- **FSOC’s report and recommendations ignore the substantial benefits of the 2010 SEC reforms.**
 - FSOC asserts that the SEC’s 2010 reforms did not address certain activities and practices of money market funds that continue to make the funds vulnerable to redemption pressures.
 - The 2010 amendments to money market fund regulation, however, have made these funds even more stable, liquid, and transparent than ever before.
 - Those reforms have been proven in the U.S. and European debt crises of 2011.
 - Investors withdrew \$216 billion from prime money market funds over the six-month period from June to November 2011. The funds accommodated these sizable outflows in an orderly manner, having plentiful liquidity to meet redemptions.
 - This was confirmed by the SEC Staff Study, which found that money market funds in 2011, unlike those in 2008, had “sufficient liquidity to satisfy investors’ redemption requests.”
 - FSOC’s concerns about the ability of money market funds to meet large-scale redemptions reflect an out-of-date view of the industry that ignores the 2010 amendments. FSOC must analyze these funds as they exist today, not through the outdated lens of 2008.
- **FSOC myopically focuses only on money market funds, ignoring the fact that the characteristics and “risks” it identifies in money market funds and their investors are common to other cash management products and participants in the broader money markets.**
 - For example, FSOC does not provide any analysis demonstrating that investors in money market funds are unique or more risk averse than other investors in the money markets.
 - Data show cash holdings continuously flow between money market funds and other types of cash products –demonstrating that money market funds are not unique in providing a means for risk-averse investors to invest in the short-term markets.

- FSOC contends that use of amortized cost accounting and the stable, rounded \$1.00 NAV creates risk by obscuring daily movements in prices.
 - Somewhat disingenuously, FSOC fails to acknowledge that amortized cost accounting is a well-established valuation method for short-term securities generally.
 - FSOC overlooks the fact that the stability of a money market fund's share price is largely attributable to the short-duration, high-quality nature of its portfolio securities not to amortized cost accounting.
 - For example, virtually all prime money market funds recorded an average absolute change in their mark-to-market values of 1 basis point or less between January 2011 and July 2012.
- FSOC also fails to acknowledge that investors always have some incentive to redeem out of or sell any financial product—be it a bank deposit, a stock, a bond, or any other instrument—if they fear losses.
- Focusing on one single product in the money markets will result in flawed policy and will not address issues that are in fact features of the short-term markets or their investors in general.

For more information on money market funds, their role in the economy, ICI's efforts to make these funds more resilient in the face of adverse market conditions, and the significant risk of undermining money market funds' value to investors and the economy, please see www.ici.org/mmfs or www.PreserveMoneyMarketFunds.org.