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ICD Portal Says Nein to Money Market Fund Reforms in New White Paper

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Online money market mutual fund trading portal Institutional Cash Distributors (ICD) published a "white paper" yesterday entitled, "Money Market Fund Reform Option #9," which "contends that significant corrective reforms made to Rule 2a-7 by the U.S. Securities and Exchange Commission in 2010 are already in place and working." A press release argues, "[T]he synthesis of the new fund data made available from these 2010 reforms, combined with new industry exposure analytics applications developed by ICD, have resulted in a comprehensive, end-to-end MMF investing process that the market place is widely adopting. This is Option #9."

The release explains, "There is an ongoing and spirited debate about how to best reduce Money Market Funds' (MMF) susceptibility to systemic risk. The October 2010 President's Working Group (PWG) Money Market Fund Reform Options report provided ... eight [possible] reform options and summarize[d] the potential pros and cons of their implementation.... This ICD commentary contends that the significant corrective reforms made to Rule 2a-7 by the SEC in 2010 are already in place and working, and that these reforms have been proactively adopted by industry leaders."

ICD's paper states, "Money Market Fund Reform Option #9 makes best use of the 2010 SEC Rule 2a-7 fund holdings disclosures and minimum liquidity requirements amendments in innovating new MMF investment guidelines and exposure analytics applications. Further, this industry-adopted solution -- referred to collectively as Option #9 -- has reduced the critical risk management gaps that caused the run on MMFs in 2008."

They comment, "The notion that money market funds were the cause -- the ground zero of the financial crisis -- is to misunderstand the real causes and to misrepresent the role of corporate treasurers.... Their investment objectives are first and foremost preservation of capital, followed by liquidity, and then yield. Prior to 2008, investors, believing that all triple-A rated funds were equally safe in regards to preservation of capital and liquidity, focused more on yield. As the subprime mortgage backed securities were bundled into even bigger mortgage derivatives and the toxicity spread worldwide the credit ratings agencies continued to provide triple-A ratings to prime funds even as several fund managers took exceptional risks to increase their fund yields. Investors were blind to these foreboding exposures."

ICD continues, "On September 16, 2008, the day after Lehman Brothers Holdings Inc. filed for bankruptcy, the Reserve Primary Fund, "broke the buck" as the Net Asset Value for the fund dropped below the stable price of $1.00 per share. Investors, without the benefit of fund analytics

to assess underlying exposures of their portfolio positions, were unable to quickly or reliably differentiate between funds and were forced to sell en masse out of all Prime MMFs. Since then, corporate treasuries have accepted the 2010 SEC Rule 2a-7 reforms and have adopted the resultant new MMF investment guidelines tools and exposure analytics applications. To add additional reform measures now, specifically any of the eight reform options under consideration by the PWG, would risk destabilizing the progress that has been made internally by the industry and would create the possibility of unintended consequences that may produce new systemic risks, or worse, diminish MMFs as a viable cash management financial product."

They argue, "The damage from a diminished Money Market industry would not be isolated solely to money market funds and their investors. Money market funds are also key providers of liquidity and credit in the short term funding market.... Should these investment vehicles no longer perform their important function in the marketplace, corporations, municipalities and the federal government would have to seek access to credit through alternate means, potentially raising the cost of borrowing throughout the global economy."

Finally, ICD writes, "Draconian reforms are not the answer nor is merely agreeing to the 2010 SEC Rule 2a-7 amendments a complete solution to the problem. What is needed is an approach that leverages these 2010 reforms with technical ingenuity, business process, and wide-spread adoption to establish a self policing set of best practices that can be applied across the entire industry. Option #9 is the comprehensive solution that enables the corporate investor to drive the marketplace to a state of enhanced security and reduced credit and liquidity risk."