THE BOND BUYER

The Daily Newspaper of Public Finance

Friday, March 2, 2012

Regulators Should Tread Lightly on Money Market Funds

By Catherine A. Provencher

As treasurer of the State of New Hampshire, I rely on the availability of a variety of financing tools and techniques to manage and protect the financial assets of our state. For deployment of the state's funds, the Treasury utilizes traditional bank accounts as well as money market mutual funds to optimally manage cash on hand.

Over the last 40 years money market funds have become a mainstay of the financial marketplace and a key component of the U.S. economy. It is especially important now, with the Securities and Exchange Commission indicating that new proposals to further regulate money market funds may be imminent, for regulators to pause and consider how these new rules may affect money market funds.

Of particular note, these funds serve as a cost-effective source of short-term financing for both the public and private sector and also as a convenient, dependable way for millions of individuals, companies and public entities such as the state to save and manage their cash.

In New Hampshire, money market funds provide financing so the state can build and maintain schools, roads and bridges that in turn help promote job creation and support the local economy. The Treasury also utilizes these funds as a vehicle to invest the state's excess cash, while maintaining essential liquidity and preserving the value and safety of principal.

On a broader scale, roughly 60% of the short-term debt issued by state and local governments across the nation is financed by money market funds. Money market funds are also significant purchasers of the debt businesses use to pay their payroll and other operating expenses.

Along with many other financial products, money market funds faced challenges during the 2008 financial crisis when concerns surfaced about funds' ability to maintain their stable $1 share price. As a result of the concerns, regulators moved to impose new restrictions on funds and today those offering funds are required to keep significantly more cash on hand for withdrawals and hold the maturity of the fund at two months or less.

These new restrictions have made money market funds stronger than ever before and even more capable of meeting high redemption demands from shareholders.

Despite these enhancements, regulators continue to indicate that they believe more needs to be done to strengthen the product; however, I urge them to proceed with caution. Money market funds play a vital role in our economy and any additional regulatory reform to this sector needs to be carefully considered. Misguided reforms could cripple the product, deplete or even eliminate a crucial source of funding, increase financing costs and remove a cost-effective investment alternative for safety and liquidity.

Regulatory proposals under discussion include forcing funds to either abandon a stable and historically maintained $1 share value or hold levels of capital similar to those required of the banking industry. However, instead of strengthening money market funds - as regulators have indicated is their goal - such changes could actually cause harm to consumers by limiting choice and competition and driving more savings and investments into banks, further concentrating risk.

If money market funds are required to abandon their stable $1 share price - the attribute that makes the funds effective cash-management vehicles and a comparable, competitive alternative to bank deposits - I'm concerned that investors will no longer continue to invest in these funds. In fact in some states, laws restrict state and local investments to accounts or products offering a stable value.

Many businesses face similar requirements that are imposed by regulation, policy or constraints to their systems. So the result of abandoning the stable share price would likely lead to the severe contraction of the money market fund industry.

As mentioned previously, another impracticable option would be to impose capital requirements intended for banks. Many investors select money market funds as a place to invest their cash precisely because they are not bank products. The manner in which banks and money market funds are structured, regulated and operated are entirely different, so it is not appropriate, in my view, to impose bank capital requirements on money market funds.

Money market funds own the highest quality, short-dated and liquid securities, allowing shareholders to earn a return on their investment while retaining ready access to their cash. Imposing capital charges could erode that rate of return - already at historic lows due to the current interest rate environment - and result in higher costs being passed along to investors.

As a state treasurer, I am extremely concerned about the efforts of regulators to pursue further changes that could lead to the possible demise of money market funds.

Such reforms could dramatically alter the availability, effectiveness and efficiency of money market funds, rendering them a less-useful source of investing and financing for all involved.

If money market funds do not remain a viable product, I — along with many colleagues in other states — would have to look for alternative sources of financing that could be more difficult and costly to obtain, leaving less money available to build our schools and roads, ultimately to the detriment of our taxpayers.

Certainly, it is sensible to conduct a broad review of existing regulatory controls with the goal of enhancing the safety and stability of all investment products. While options to further reduce risk should always be considered, the value proposition and choice inherent in money market funds must remain in place.

I urge regulators to reconsider the reform options currently on the table. Maintaining the money market fund structure as it currently exists continues to provide a widely used, stable and cost-effective investment vehicle in addition to bank deposits to diversify cash portfolios.

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