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ICI's Reid Tells Sheila Bair to Stick to the Facts on Money Funds

NOTE to Subscribers: ***Crane Data*** will be publishing the March issue of its ***Money Fund Intelligence*** and ***MFI XLS*** spreadsheet this morning. Our Feb. 29, 2012, monthly performance data, rankings, and ***Crane Indexes*** have also been updated in our ***Money Fund Wisdom*** database. **Watch for our product e-mails shortly, or visit our Content page to download the latest files**.... A new "**Viewpoint**" article entitled, "Money Market Funds: Let's Stick to the Facts" was published yesterday by the Investment Company Institute's Chief Economist **Brian Reid**. Reid writes, "As a banking regulator who was in office during the worst banking crisis since the Great Depression, Sheila Bair knows that banks and money market funds are not the same. Yet in her recent Huffington Post piece, **Bair blurs vital distinctions in an effort to convince the reader that money market funds are in fact extremely risky banks--and thus need a stiff dose of banking regulation**."

He explains, "**For example, the former chair of the Federal Deposit Insurance Corporation (FDIC) knows that money market funds are required by law to invest in assets that pose minimal credit risk**. That's a standard that no other retail investment product--and certainly no bank--is required to meet. Only money market funds are required to invest solely in a diversified portfolio of high-quality, short-term, liquid securities. **This doesn't mean that these funds never experience losses--but their low-risk portfolios minimize the chances of loss**."

Reid says, "**Bair also knows that money market funds achieve their $1.00 share price not by acting like insured bank accounts but by managing very high quality, diversified, and liquid portfolios**. As I discussed in a recent ICI Viewpoints, "Money market funds invest in very short-term securities, and many of these securities have interest rates that reset frequently. That makes the value of these securities--and hence the funds' per-share portfolio value--extremely stable."

He continues, "Bair also asserts that outflows from prime money market funds in September 2008 were the result of Reserve Primary Fund being unable to maintain its $1.00 net asset value. **Although this is the conventional story line, it ignores the sweeping financial crisis that had overtaken the U.S. and European banking and financial sectors at the time**. At least 13 major institutions went bankrupt, were taken over, or were rescued in the 12 months before **Lehman Brothers** failed. Institutions continued to fail after Lehman--indeed, **AIG** was rescued on the same day that **Reserve Primary** broke the dollar."

Reid tells us, "**Events of that week are often portrayed as a run from money market funds. Yet for almost every dollar that came out of prime money market funds, a dollar went into Treasury and government funds**. In the week of the Lehman collapse, the assets of taxable money market funds (prime, Treasury, and government funds combined) **declined by only 4 percent. So investors weren't fleeing money market funds**. An equally plausible explanation for prime fund outflows and government money market fund inflows is that **investors were reacting to their concerns about the financial wherewithal of U.S. banks, the U.S. government's unpredictable response to financial institutions' collapse, and concerns about whether prime funds could continue to sell assets in the frozen commercial paper market**."

He states, "**Yes, the government stepped in to restore liquidity to the markets and shore up investor confidence, and the Treasury Department provided a one-year guarantee to money market funds that purchased the insurance**. But this was part of an overall set of actions to help return investor confidence to the entire financial system here and in Europe. Aside from that one-year program, money market funds have never carried a guarantee from the government or from fund sponsors. **Bair claims that investors don't understand that fact--notwithstanding that it's clearly disclosed to investors and that research shows retail and institutional investors alike understand that these funds entail risk**.... [I]n recent surveys of retail investors by Fidelity Investments, 81 percent of respondents said they understood that the securities held by money market funds had some small

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daily price fluctuations."

Reid concludes, "**Finally, Bair admonishes readers not to believe industry arguments that the SEC proposals will cause onerous tax consequences, lower returns, and potentially widespread investor flight from these funds**. That's fine--readers don't have to take our word for it. **After all, the users of money market funds, and the issuers of commercial paper and municipal securities who depend on these funds for financing, have been vociferous in making the same points**. Corporate and municipal treasurers nationwide have raised their voices against the reform proposals being contemplated by the SEC. **An honest debate on money market funds and the role they play in serving investors and the economy is healthy and welcome. But myths, errors, and hyperbole will not advance the discussion**."

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