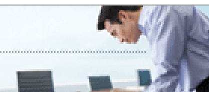

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ICI's Stevens Speaks on Money Fund Myths and Misstatements at MMX

Investment Company Institute President **Paul Stevens** gave a speech Monday morning entitled, "Preserving the Value of Money Market Funds for Investors and the Economy at the Money Market Expo in Orlando, Fla. (Note: MMX is a competitor to Crane's Money Fund Symposium.) Stevens says, " Whether you represent a company or a city government, a university or an insurance company, a pension plan or a brokerage, you know how vital the role of cash management is in your operations. **Cash is truly the lifeblood of our economy -- and the money market is the circulatory system**. Indeed, America's economy today quickly would cease to function without a steady, efficient flow of liquid resources from investors to issuers and back again. **Money market funds are a crucial component of this market**. Cash managers who need to balance daily income and outflow tell us that money market funds offer greater flexibility, diversification, and liquidity than either bank products or direct investments in money market instruments."

He explains, "**For 56 million individual investors, money market funds offer the only way to achieve a current money market yield and the safety of a diversified, professionally managed portfolio**. Since 1990, retail investors have earned $242 billion more in returns from money market funds than they would have earned in competing bank products. And the $2.7 trillion entrusted to money market funds is put to valuable uses throughout the economy -- financing commercial paper, short-term municipal debt, asset-backed commercial paper, bank CDs, Treasury bills. In short, money market funds help keep the lifeblood of the economy flowing. **The question we face today is: Do we preserve the vital role that money market funds play? Will money market funds continue to serve investors and the economy?**"

Stevens continues, "**As you all know, the Securities and Exchange Commission [SEC] has signaled its plans to unveil soon a set of structural changes to money market funds**. These proposed changes may take one of two courses. In the first option, money market funds will lose their stable $1.00 per-share value and will be forced to "float." In the second, they will be subject to a complicated regime of capital buffers and redemption restrictions. **In either case, investors tell us that regulators will have crippled the very features that make money market funds so valuable to users as cash management tools**."

He adds, "The result is predictable -- investors will reduce their use of money market funds, or abandon them altogether. **And when that happens, the flow of finance through the money markets, that lifeblood for the economy, will be disrupted, creating a market with higher costs and more systemic risk -- at great cost to investors and the economy**. Scores of organizations -- representing corporate treasurers, finance officials from state and local governments, nonprofits, financial advisers, and individual investors -- have written to the SEC warning of the consequences of misguided changes for their finances and for the economy. Many of you here may have weighed in --and if you haven't, I hope you will."

Stevens also says, "**In the fund industry, we have spent countless hours in recent years trying to help regulators find ways to make money market funds more resilient in the face of adverse markets**. We are confident we achieved that goal in 2010. With the fund industry's strong support, the SEC adopted rule amendments that raised the credit quality, shortened the maturity, enhanced the transparency, and increased the liquidity of money market fund portfolios. These reforms were tested in the troubled markets of the last year -- and they passed with flying colors. Thanks to the 2010 amendments, money market funds are stronger today -- and today's money market fund is a very different product from its 2008 predecessor.... **U.S. financial regulators should take credit for this success. Few do**."

He continues, "**Instead, SEC Chairman Mary Schapiro pre-judged the force of the 2010 amendments**. Even before voting on them, she declared that regulators wanted a "Round II" of "

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structural changes" to money market funds. **Two years later, as we see the SEC's trial balloons, we're discovering that "structural change" means proposals that will undermine the core features of money market funds and their value to investors and the economy**. The fact that the power of the 2010 reforms is not acknowledged -- that's disappointing."

Stevens explains, "Even more troubling are the arguments that critics use to justify changes that clearly will undermine the value of money market funds to investors and the economy. **The debate around money market funds is riddled with myths and misstatements**. There are at least three big myths at the heart of the case for "reforming" money market funds. First, there's the **myth of 2008 -- the notion that money market funds somehow caused or accelerated the financial crisis**. That's a false narrative, and it's the source of a great deal of mischief. The myth of 2008 feeds another misconception -- **the myth that money market funds are "susceptible to runs" and likely to trigger systemic risk**. And in the hands of some commentators, these first two myths fuel a third. **That's the notion that banks offer the superior model for all financial activities and that capital market institutions like money market funds are really "shadow banks."** This myth leads to proposals to impose bank-style regulation on money market funds. **Take these three myths together, and we end up where we are today -- rushing headlong into unnecessary, flawed, and harmful regulatory changes**."

He explains, "**In fact, while the eurozone and U.S. debt crises certainly took their toll on equity and fixed income markets, the withdrawal from money market funds had no discernable effects at all -- either on the funds or on the markets**. Consider this: from April through December, prime money market funds kept their daily liquidity at more than twice the required level, and weekly liquidity stayed one-third to one-half higher than the standard. **Did the redemption pressure put any funds at risk of breaking the dollar?** We've examined the portfolio data that all money market funds now are required to file with the SEC for public release. **Among the prime funds with the greatest exposure to European financial institutions, the average mark-to-market price of their portfolio fell by nine-tenths of a basis point**. Let me see ... on a $1.00 fund share, that's a dollar sign followed by 0-point-0-0-0-0-9. Right. Nine one-thousands of a penny. Put it another way -- that change wouldn't move the value of a share priced at $1.00, and it wouldn't move the value of a $10 share. **It would move the value of a share priced at $100 -- by one cent**. We can't call that breaking the buck -- so I guess we'd have to call it "breaking the Benjamin." **So -- have the 2010 amendments been tested? Yes**."

Stevens tells us, "**Nonetheless, the false narrative of 2008 fuels the second myth of this debate -- the idea that money market funds are "susceptible to runs."** I'll quote Chairman Schapiro again. She says: "Funds remain vulnerable to the reality that a single money market fund breaking of the buck could trigger a broad and destabilizing run." I wanted to be on solid footing here, so I took out my dictionary. It says that the word "vulnerable" means ... "susceptible." So I looked up "susceptible." That means "easily influenced ... likely to be affected." **That certainly doesn't describe money market funds**. They are not "easily" broken. Nor are they "likely to be affected" in a significant way outside of extreme market conditions."

He explains, "**We all know that, in the first 25 years after Rule 2a-7 was adopted, exactly one money market fund broke the dollar, in 1994**. This is a sophisticated audience, but I doubt that 10 people in this room could name that fund. Do I have any takers? It was the **Community Bankers U.S. Government Money Market Fund**. The reason it's not famous is because it broke the dollar and did not trigger a broad and destabilizing run. In fact, money market fund assets grew the month after Community Bankers broke the dollar. **The contrast between September 1994 and September 2008 is the fact that, in 1994, the banking system was not mired in crisis**. There was no reason for investors in other funds to lose confidence in the assets their funds were holding. And so there were no aftershocks. **When Reserve Primary failed in 2008, there were aftershocks -- caused, as I said, primarily by the financial crisis in which Reserve's failure was but one more of a seemingly endless series of events**. And, as I noted, investors didn't lose confidence in the money market fund structure. **So I would submit to you that money market funds have never been "susceptible to runs**.""

Stevens tells MMX, "**And here in the United States, money market funds aren't just "useful" -- they're essential**. Any vehicle that funds more than one-third of the commercial paper market and more than one-half of short-term municipal debt should not -- cannot -- be viewed as an afterthought. **Finally, I hope you all know that money market funds are not banks, and that they don't need bank-style regulation**. Banks are highly leveraged: 80 to 90 percent of the liability side of their balance sheets is deposits, CDs, long-term bonds, and other borrowings. They invest these borrowed funds in mortgages and other long-term loans, for households, small businesses, and other borrowers who lack access to public credit markets.... **By contrast, money market funds' use of leverage is tightly limited -- and these funds typically make very limited use of borrowed funds**. Indeed, the liability side of a money market fund's balance sheet is essentially 100 percent capital. **Money market fund shareholders are equity investors -- with all of the risks of ownership, fully disclosed**."

Finally, he says, "**It's frustrating that the public dialogue is so riddled with myths and misconceptions**. It's disappointing that the success of the 2010 amendments is ignored in the pursuit of changes that will compromise core features of money market funds, their utility to investors, and ultimately their role in the economy. It seems clear that we are now approaching a critical juncture in this debate. We will muster all of our resources, in legal and economic analysis, in operational expertise and communications, to alert investors, issuers, businesses, state and local governments, and political

leaders to the implications of any proposed structural changes. Why? Because this is a matter that is bigger than the fund industry alone. Earlier I mentioned that scores of organizations representing investors and issuers have already spoken out against ideas like the floating NAV. If you want to add your voice ... you can find us on the Internet at www.PreserveMoneyMarketFunds.org. **Please add your voice to the chorus, and keep money market funds working for us all**."

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