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April 13, 2012

The Honorable Mary L. Schapiro  
Chairman  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: ICI Viewpoints

Dear Chairman Schapiro:

As the Securities and Exchange Commission continues to contemplate whether any additional regulation of money market funds is appropriate, we offer for your consideration the attached set of recent Investment Company Institute Viewpoints relating to money market funds. These on-line postings, which help us carry out one of ICI's most important missions: to promote public understanding of investment companies, offer analysis and opinion from ICI in-house experts in economics, law, and fund operations on a variety of key issues affecting money market funds, including their European exposures and the effect of forcing these funds to float their net asset values. All ICI Viewpoints relating to money market funds can be found here:  
<http://www.ici.org/viewpoints?tag=Money%20Market%20Funds>.

We appreciate the opportunity to provide additional information relating to money market funds, which serve as an effective cash management tool for investors, and as an indispensable source of short-term financing for the global economy. If you have any questions or if we can provide any additional information, please contact me at 202-326-5815 or Brian Reid, ICI Chief Economist, at 202-326-5917.

Sincerely yours,

/s/ Karrie McMillan

Karrie McMillan  
General Counsel

cc: James R. Burns, SEC Deputy Chief of Staff  
Jennifer B. McHugh, Senior Advisor to the Chairman

Paul Schott Stevens, President & CEO, Investment Company Institute

## Money Market Funds and Financial Stability: Reason and the Facts Must Guide Regulators

By Paul Schott Stevens

APRIL 04, 2012

We are pleased to see that the Financial Stability Oversight Council continues to take a thoughtful approach on the issue of designating "systemically important financial institutions." That's in stark contrast to some commentators, who would have regulators rush to put money market funds under that designation. As ICI has argued in a number of venues, a "SIFI" designation is inappropriate for these funds and plainly would run counter to facts and reason. Let's review why.

### Money Market Funds Have Stringent Risk-Limiting Characteristics

One key reason why the SIFI designation is not appropriate for money market funds is that these funds are among the most strictly regulated financial products offered to investors. As ICI conveyed to the Financial Stability Oversight Council (FSOC) in a 2011 letter, money market funds must comply with the comprehensive requirements of the Investment Company Act—plus an additional set of regulatory requirements specific to these funds.

These legal requirements, recently strengthened by the Securities and Exchange Commission in 2010, include tough standards on credit quality, liquidity, maturity, and diversification. The basic objective here is to limit a fund's exposure to credit risk, interest rate risk, liquidity risk, and the risk that big shareholders may suddenly exit a fund.

### Industry-wide Reforms Have Proven Remarkably Effective

Critics of money market funds frequently fail to recognize the 2010 SEC updates—and their success. As I've discussed recently, money market funds, under these enhanced regulatory requirements, have weathered three severe challenges: the European sovereign debt crisis, the impasse over the U.S. federal debt ceiling, and the historic downgrade of the U.S. debt rating—all while enduring the long-running punishment of near-zero interest rates.

These challenges prompted investor movement out of money market funds; last summer's outflows were significant. Yet money market funds easily met these redemptions because the funds held liquidity that met and exceeded the standards set by the 2010 reforms.

This industry-wide approach makes far more sense than designating hundreds of money market funds—or even just prime money market funds—offered in the U.S. market as SIFIs, thus subjecting each to inappropriate, bank-like prudential standards applied by the Federal Reserve Board.

### Money Market Funds are Not "Shadow Banks"

In a recent editorial, *Bloomberg View* addressed these matters by, unfortunately, perpetuating the misperception that money market funds are "shadow banks." In comment letters and elsewhere, we've confronted this misperception. I commend readers to a December ICI Viewpoints post by ICI Chief Economist Brian Reid, who succinctly reviews why it's wrong to assume that all investing and lending that occurs outside the banking system is somehow shadowy or inappropriate. Namely:

Banking and capital markets are both highly regulated and have successfully coexisted for centuries.

Robust capital markets add resiliency to the financial system, because the capital markets sometimes weather times of crisis better than banks.

Moving more financial activity into the banking system will concentrate risks and make the financial system more vulnerable.

Bloomberg's editorial urges FSOC to err on the side of "[sweeping] up more firms than it expected to have to oversee." We urge the FSOC to err on the side of reason and the facts.

Paul Schott Stevens has served as President and Chief Executive Officer of the Institute since June 2004.

## What Happens If 'Floating' Funds Don't Float?

By Jane Heinrichs and Greg Smith

MARCH 29, 2012

Some recent coverage—including the *CFO Journal* blog of the *Wall Street Journal*—suggests that worries about the impact on investors of forcing money market funds to float their net asset value (NAV) may be overblown. The story goes like this: the mark-to-market prices of money market funds, and the experience of a few money market funds that already operate with a floating NAV, show that fluctuations in the "floating" value would be minuscule—rarely large enough to change the penny-rounded per-share price of the fund. So if floating funds don't float, what's the harm?

Well, there are two problems—cost and benefit. Floating funds that don't float will bring very high costs—but they won't provide any benefits. That's a bad deal all around.

Regulations that require money market funds to abandon their stable \$1.00 NAV will impose very substantial costs on investors and funds whether the funds' actual per-share values ever move or not.

State laws and investment policies bar many governmental bodies, nonprofits, and businesses from investing cash in floating-value products, so those investors would have to retool their cash management and give up the convenience, stability, and liquidity of money market funds. Accounting standards setters aren't likely to grant cash-equivalent status to floating-value money market funds, which means institutions would have to track and reflect any fluctuations in shares' values on their books. Individuals and many institutional investors would have to regard every money market fund transaction as a potentially taxable event, and funds would have to build reporting systems to track gains and losses in the pennies.

In short, the fact that money market funds *could* float means that investors, funds, and intermediaries have to be prepared that they *will* float. Changing the nature of these funds from stable to floating would force funds and investors to adapt, build new accounting systems, and overhaul their cash management—whether the funds' value actually fluctuates or not. The result would be heavy costs.

And on the benefit side of the balance? Securities and Exchange Commission (SEC) Chairman Mary Schapiro has said, "these proposals are designed to...desensitize investors to the occasional drop in value." The SEC reasons that if investors see the value changing frequently, they won't redeem in turbulent markets. We don't agree with that line of argument; the SEC has offered no evidence to support it; and there's plenty of evidence that investors behave differently in crisis than in normal markets. In any case, if in practice a fund's value never changes, investors won't be "desensitized"—and none of the benefits that the SEC hopes to gain will materialize.

In fact, we would agree that floating funds aren't likely to float. Look at what happened to money market funds' mark-to-market values last summer, at the height of the eurozone crisis. Studying the prime funds with the greatest exposure to European financial institutions, we found that their floating value dropped by 0.9 basis points. On a \$1.00 share, that's nine one-thousandths of a penny.

That kind of float is not going to move a share priced at \$1.00; in fact, it would not move a \$10 share. It might—in extreme conditions like the eurozone crisis—move the price of a \$100 share. So, if the SEC really wants money market funds to float enough to register at all on investor psychology, our research suggests that they're going to have to reprice them to \$1,000 a share.

Huge costs for zero benefits—our economists tell us that's a cost-benefit ratio that rapidly approaches infinity. What we calculate is that floating funds are a bad deal for investors and the economy.

Jane Heinrichs is Senior Associate Counsel in ICI's Law Department and Greg Smith is Director of Compliance and Accounting in ICI's Operations Department.

## Bringing Money Market Funds' European Investments into Focus

By Brian Reid

MARCH 21, 2012

In his written testimony on Capitol Hill today, Federal Reserve Board Chairman Ben Bernanke created a fuzzy and incomplete picture of money market funds and their investments in European-headquartered financial institutions. Whether by intent or not, the Fed testimony left the impression—magnified by media accounts—that these funds have a unique and substantial vulnerability to any future turmoil in overseas markets.

The full picture: the majority of money market funds' European exposure is invested in banks that are integral players in the U.S. financial system—including banks that are on the Fed system's own list of official counterparties. The fact that they're getting some of their financing from money market funds doesn't add risk to the U.S. financial system.

What's unfortunate is that all the data that the Fed would need to provide a clearer picture are publicly available. We've been pointing out the exaggerations in coverage of this issue for the last nine months.

The Fed chairman made headlines with his statement that investments in European banks made up 35 percent of the portfolios of U.S. prime money market funds in February. That's true. But while his testimony was careful to explain away the exposures that U.S. banks have to potential financial strains in Europe, it failed to provide any of the detail that would put money market funds' investments into similar context.

First, it's important to note that European-based financial institutions that borrow in the short-term U.S. dollar market are typically large global banks with operations stretching well beyond Europe's borders—including in the U.S.

There's also the fact that Europe is a big continent, and the risks of the eurozone debt crisis aren't spread evenly. Bernanke correctly noted that "U.S. money market funds have almost no exposure" to "the most vulnerable euro-area countries."

In fact, more than half of prime money market funds' European holdings are in banks headquartered in the United Kingdom, Sweden, and Switzerland—all countries that don't use the euro for currency, and thus are outside the single-currency zone that's vulnerable to debt crises in Greece and other "peripheral" countries.

Money market funds' holdings in the eurozone amount to 15.5 percent of their portfolios, and virtually all of those holding are in banks headquartered in Europe's strongest economies—France, Germany, and the Netherlands.

To get the most accurate picture, it helps to drill down to the holdings in individual banks. We can do that because money market funds are the most transparent financial product in America, disclosing every holding in their portfolios to the public every month. Here's what we find:

52 percent of U.S. money market funds' holdings of European-based institutions are invested in securities of banks that have U.S. affiliates that serve as "primary dealers." Primary dealers are financial institutions designated by the Federal Reserve Bank of New York to serve as trading counterparties in the Fed's implementation of monetary policy. These dealers are required to participate every time the U.S. Treasury auctions its securities. They are central players in the U.S. financial system.

Among the instruments of these primary dealers that U.S. prime money market funds hold, half (51 percent) are repurchase agreements. Such repos are fully collateralized, usually with U.S. Treasury and government agency securities that these institutions hold precisely because they are primary dealers.

When money market funds invest in European banks that aren't primary dealers, they tend to be institutions with significant U.S. operations, even if they're not household names. For example, Rabobank Nederland NV has both retail and corporate banking operations in the United States.

Institutions like Barclays, Deutsche Bank, UBS, HSBC, and Credit Suisse are deeply embedded in the U.S. financial markets. The fact that money market funds buy their short-term debt does not create unique risks to the U.S. financial markets. In fact, as primary dealers, these European-headquartered banks would be heavy borrowers in the U.S. markets even if money market funds didn't exist.

Congress and the public deserve a clear picture of financial risks, and the details do matter.

Here's the latest data on U.S. prime money market funds' holdings by country.

**Prime Money Market Funds' Holdings by Home Country of Issuer**  
February 29, 2012

<b>Country</b>	<b>Billions of dollars</b>	<b>Percentage of total assets</b>
<b>World Total</b>	<b>\$1,409.7</b>	<b>100%</b>
<b>Europe</b>	<b>506.6</b>	<b>35.9</b>
<i>Eurozone</i>	<i>217.7</i>	<i>15.5</i>
France	77.3	5.5
Germany	72.4	5.1
Netherlands	62.3	4.4
Belgium	2.3	0.2
Austria	2.5	0.2
Spain	0.9	0.1
Luxembourg	0.0	0.0
Italy	0.0	0.0
<i>Non-eurozone</i>	<i>287.9</i>	<i>20.5</i>
UK	135.6	9.6
Sweden	67.2	4.8
Switzerland	62.8	4.5
Norway	18.8	1.3
Denmark	3.5	0.3
<b>Americas</b>	<b>653.9</b>	<b>46.4</b>
USA	505.9	35.9
Canada	147.5	10.5
Chile	0.4	0.0
Venezuela	0.1	0.0
<b>Asia and Pacific</b>	<b>248.4</b>	<b>17.6</b>
Japan	126.1	8.9
AUS/NZ	118.4	8.4
Singapore	3.2	0.2
India	0.4	0.0
China	0.3	0.0
Korea	0.0	0.0
<b>Supranational</b>	<b>0.9</b>	<b>0.1</b>
<b>Unclassified</b>	<b>0.9</b>	<b>0.1</b>

Note: Calculations are based on a sample of 104 funds, representing an estimated 96.4 percent of prime funds' assets.  
Source: Investment Company Institute tabulation of data provided by Crane Data

Brian Reid is ICI's Chief Economist.



## Money Market Funds: Let's Stick to the Facts

By: Brian Reid

MARCH 06, 2012

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.

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.

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."

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.

Events of that week are often portrayed as a run from money market funds. Yet for every dollar that came out of prime money market funds, 63 cents 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. As investors often do in times of financial turmoil, they sought the refuge of the U.S. Treasury market.

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. Holders of institutional funds, which account for more than three-fifths of the \$2.7 trillion invested in money market funds, certainly can distinguish between these funds and bank accounts. And retail investors are not ill-informed, either: in 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 daily price fluctuations.

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.

Brian Reid is ICI's Chief Economist.

This section has been updated. An earlier version said that "almost every dollar that came out of

prime money market funds" was matched with a dollar flowing into Treasury and government funds. The updated version presents more precise data.

## The Honest Truth About Forcing Money Market Funds to Float

By Brian Reid

FEBRUARY 29, 2012

Advocates for further regulation of money market funds string together a loose chain of arguments to create the impression that money market funds are bank products, rather than investment securities. From this, they conclude that these funds need bank-like regulation. Sallie Krawcheck's commentary in today's *Wall Street Journal* is the latest effort in this campaign.

The reasoning usually goes like this: money market fund investors don't know what they're buying. Because the funds are managed to maintain a \$1.00 share price, advocates of regulation argue that investors are lulled into believing that money market funds carry implicit guarantees. There's usually a reference to "honest accounting," with the implication that fund sponsors are hiding large fluctuations in the shares' "true prices." The solution, advocates say, is to "float" the share price, pass all those fluctuations on to investors, and thus demonstrate to investors that what they're holding is not a static bank account, but a security that carries risks.

There are flaws in every link of this chain—starting with the premise that investors are ignorant. Holders of institutional funds, which account for more than three-fifths of the \$2.7 trillion invested in money market funds, certainly know the difference between a fund and a bank account. And retail investors are not ill-informed, either: In recent surveys by Fidelity Investments, 81 percent of retail investors said they understood that the securities held by money market funds had some small daily price fluctuations.

The notion that funds maintain their stable \$1.00 price through implicit guarantees is also wrong. In truth, portfolio construction explains most of the stability: money market fund portfolios are designed to minimize risk and price fluctuations.

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. As my colleagues and I wrote in a paper last year, interest rates would have to rise by 1 percentage point in a single day to reduce the portfolio value of the average \$1.00 fund with a 45-day weighted average maturity by \$0.0012 (about 0.1 cent). How often do such extreme interest rate changes occur? In the past 30 years, there has only been one day (February 1, 1982, to be specific) when three-month Treasury bill rates changed by more than 1 percentage point.

The stability of money market fund portfolios is demonstrated in historical data. For our paper, we collected mark-to-market prices from a sample of money market funds from 2000 to 2010. For prime funds (those that invest in commercial paper as well as government securities), the average "shadow price" never fell more than 0.1 cent below \$1.00 until September 2008, when interest rates rose over several days. And even then—at the worst point in the worst financial crisis in 70 years—the average shadow price was only 0.2 cents below \$1.00.

That record of stability was earned before the Securities and Exchange Commission (SEC) adopted amendments to money market fund regulation in 2010 that required funds to shorten the maturities and durations of their portfolios even further and to carry more liquid assets. Those rule amendments have made funds' mark-to-market share prices even more stable.

We've had a case study to prove that point. Last summer, three significant events rattled financial markets. The eurozone struggled to get ahead of the growing possibility of a Greek sovereign debt default. The U.S. Congress waited until the eleventh hour to increase the U.S. debt ceiling. And then, shortly afterward, Standard & Poor's downgraded the rating of U.S. government long-term debt.

What happened to money market funds' mark-to-market prices during the period from the end of May to the end of September? Very little. Using data that these funds provide to the SEC for public release, we can track the underlying prices of prime money market funds.

Among those funds that held the greatest share of their portfolios in dollar-denominated debt issued by the European-based financial institutions, the average share price of a fund with a \$1.00 net asset value (NAV) fell by 0.9 basis points, or \$0.00009. In other words, the price of a \$1.00 fund slipped to \$0.99991. For funds with the least exposure to European banks, the average mark to market share price rose by 0.3 basis points, or \$0.00003, to \$1.00003.

When a \$1.00 fund moves by 1 cent, it's said to have "broken the dollar." In last summer's scenario, funds would have to have been priced at \$100.00 a share for even a few funds to have moved one penny. (Maybe "break the Benjamin" would be the new term of art.) In any case, it's hard to argue that pricing a \$0.99991 share at \$1.00 is somehow not "honest accounting."

Some commentators believe that this type of fluctuation will convince investors that these funds contain assets that can lose value or provide more "honest accounting." False precision is not honest.



and it is hard to imagine that investors would find these fluctuations to be meaningful. Floating the value of money market funds would create distinctions without a difference—an illusory benefit at best.

At the same time, the costs—in accounting, transactional, and tax hurdles for investors forced to track these minute changes in every transaction they make—will be very real, and very expensive. As we have said many times before, floating the price or imposing bank-like regulation will serve primarily to drive investors out of money market funds.

For more information, please visit ICI's [Money Market Funds Resource Center](#).

Brian Reid is ICI's Chief Economist.

## Prime Money Market Funds' Eurozone Holdings Remain Low

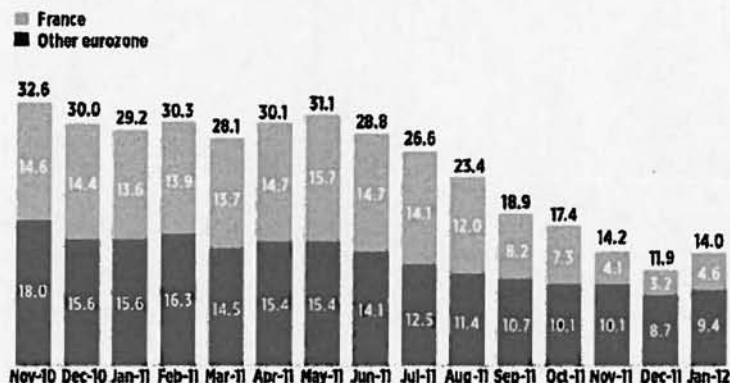
By Emily Gallagher and Chris Plantier

FEBRUARY 23, 2012

Securities of eurozone issuers accounted for 14.0 percent of assets of U.S. prime money market funds in January, up from 11.9 percent in December (chart). This increase was driven by a rise in French assets (up from 3.2 percent to 4.6 percent) and by a rise in asset holdings of other eurozone issuers (up from 8.7 percent to 9.4 percent).

### U.S. Prime Money Market Funds' Holdings of Eurozone Issuers

Percentage of prime funds' total assets, end of month



Note: Data exclude prime money market funds not registered under the Securities Act of 1933.

Sources: Investment Company Institute tabulation of publicly available Form N-MFP data prior to May 2011; ICI tabulation of data provided by Crane Data thereafter

The European Central Bank's massive long-term refinancing operation on December 22 provided nearly 500 billion euros in three-year liquidity to the eurozone banking system. Market sentiment has improved since this policy action, leading some commentators to suggest that U.S. prime money market funds' increase in eurozone holdings in January reflects a renewed appetite for risk.

A closer look, however, undercuts that argument. In particular, the maturity of prime money market fund holdings of French issuers continued to fall in January. At the end of January, 85 percent of these French holdings matured in seven days or less, up from 78 percent at the end of December. These funds' French holdings are considerably more concentrated at the short end of the maturity scale than are their German or British securities. What's more, these funds' French holdings of securities with maturities beyond seven days were little changed in dollar terms, suggesting that prime money market funds remain cautious.

### Prime MMFs Shortened Maturities of French Holdings

Percentage of assets by maturity, month-end

		Days to Maturity			
Country	Date	1 to 7	8 to 30	31 to 60	91+
<b>France</b>					
	Nov 11	72	14	12	1
	Dec 11	78	10	11	1
	Jan 12	85	10	4	1
<b>Germany</b>					
	Nov 11	54	29	16	1
	Dec 11	59	25	15	1
	Jan 12	50	21	25	5
<b>UK</b>					
	Nov 11	58	19	17	7
	Dec 11	48	32	16	5

	Jan 12	49	30	18	3
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With this in mind, the small increase in prime money market funds' holdings of eurozone issuers should not be viewed as an increase in willingness to take on risk. Instead, the increase probably has more to do with typical year-end effects in December's holdings data.

In October and December, we discussed how portfolio managers of U.S. prime money market funds have addressed the ongoing debt crisis in the eurozone. As the chart above of U.S. prime money market funds' holdings of eurozone issuers from November 2010 to January 2012 shows, January's increase in eurozone securities to 14.0 percent marked a return to the November level (14.2 percent).

A December drop in eurozone holdings may well be typical and one month's data certainly does not make a trend. While we do not have a long history of prime money market funds' monthly holdings to judge seasonal effects, we do have holdings data going back to November 2010. U.S. prime money market funds' eurozone holdings fell by 2.6 percentage points in December 2010, well before the eurozone debt crisis widened in the second half of 2011—similar to the 2.3 percentage point decline from November to December 2011.

As a result, we would be extremely careful in calling a turning point in prime money market funds' willingness to hold eurozone issuers based solely on January's holdings data. What's probably more significant is that prime money market funds' eurozone holdings remain low and short-dated as fund managers continue to act prudently in the face of the ongoing debt crisis.

Country	Billions of dollars	Percentage of assets
<b>World Total</b>	<b>\$1,368.5</b>	<b>100%</b>
<b>Europe</b>	<b>502.8</b>	<b>36.8</b>
<i>Eurozone</i>	<i>191.2</i>	<i>14.0</i>
France	63.6	4.6
Germany	61.6	4.5
Netherlands	60.1	4.4
Belgium	2.1	0.2
Austria	2.5	0.2
Spain	1.2	0.1
Luxembourg	0.0	0.0
Italy	0.1	0.0
<i>Non-eurozone</i>	<i>311.6</i>	<i>22.8</i>
UK	137.1	10.0
Switzerland	82.1	6.0
Sweden	73.6	5.4
Norway	15.2	1.1
Denmark	3.6	0.3
<b>Americas</b>	<b>627.3</b>	<b>45.8</b>
USA	486.7	35.6
Canada	140.1	10.2
Chile	0.3	0.0
<b>Asia and Pacific</b>	<b>234.7</b>	<b>17.1</b>
AUS/NZ	120.2	8.8
Japan	111.9	8.2
India	0.6	0.0
Singapore	1.8	0.1
China	0.2	0.0
Korea	0.0	0.0
<b>Supranational</b>	<b>1.0</b>	<b>0.1</b>

Unclassified	2.7	0.2
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Note: Calculations are based on a sample of 104 funds, representing an estimated 94.9 percent of prime funds' assets.

Source: Investment Company Institute tabulation of data provided by Crane Data

For more on money market funds, please visit ICI's [Money Market Funds Resource Center](#).

Emily Gallagher is an ICI Research Associate, and Chris Plantier is an ICI Senior Economist.

### Data Update: Money Market Funds and the Eurozone Debt Crisis

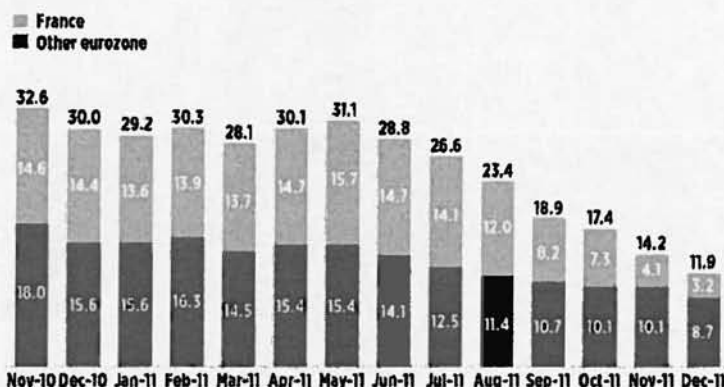
By Emily Gallagher and Chris Plantier

JANUARY 13, 2012

In October and December, we discussed how portfolio managers of U.S. prime money market funds have addressed the ongoing debt crisis in the eurozone. Here is a look at the latest monthly data on these funds' holdings by home country of issuer. Holdings of French issuers continued to fall in December, and almost 80 percent of these French holdings are either short-dated collateralized repurchase agreements or other instruments that mature in seven days or less. We will revisit the topic in mid-February with updated analysis once January figures become available.

#### U.S. Prime Money Market Funds' Holdings of Eurozone Issuers

Percentage of prime funds' total assets, end of month



Note: Data exclude prime money market funds not registered under the Securities Act of 1933.

Sources: Investment Company Institute tabulation of publicly available Form N-MFP data prior to May 2011; ICI tabulation of data provided by Crane Data thereafter

#### Prime Money Market Funds' Holdings by Home Country of Issuer

December 31, 2011

Country	Billions of dollars	Percentage of assets
<b>World Total</b>	<b>\$1,347.0</b>	<b>100%</b>
<b>Europe</b>	<b>464.6</b>	<b>34.5</b>
<i>Eurozone</i>	<i>159.9</i>	<i>11.9</i>
France	43.1	3.2
Germany	57.9	4.3
Netherlands	55.7	4.1
Belgium	0.5	0.0
Austria	2.0	0.1
Spain	0.6	0.0
Luxembourg	0.1	0.0
Italy	0.0	0.0
<i>Non-eurozone</i>	<i>304.7</i>	<i>22.6</i>
UK	123.7	9.2
Switzerland	86.9	6.5
Sweden	78.1	5.8
Norway	12.6	0.9
Denmark	3.4	0.3
<b>Americas</b>	<b>630.1</b>	<b>46.8</b>



USA	476.1	35.3
Canada	153.6	11.4
Chile	0.4	0.0
<b>Asia and Pacific</b>	<b>237.2</b>	<b>17.6</b>
AUS/NZ	116.0	8.6
Japan	119.3	8.9
India	0.5	0.0
Singapore	1.4	0.1
Korea	0.0	0.0
<b>Supranational</b>	<b>1.2</b>	<b>0.1</b>
<b>Unclassified</b>	<b>13.9</b>	<b>1.0</b>

Note: Calculations are based on a sample of 100 funds, representing an estimated 93.7 percent of prime funds' assets.

Source: Investment Company Institute tabulation of data provided by Crane Data

For more on money market funds, please visit ICI's [Money Market Funds Resource Center](#).

Emily Gallagher is an ICI Research Associate, and Chris Plantier is an ICI Senior Economist.

## Money Market Funds Continued to Reduce Eurozone Holdings In November

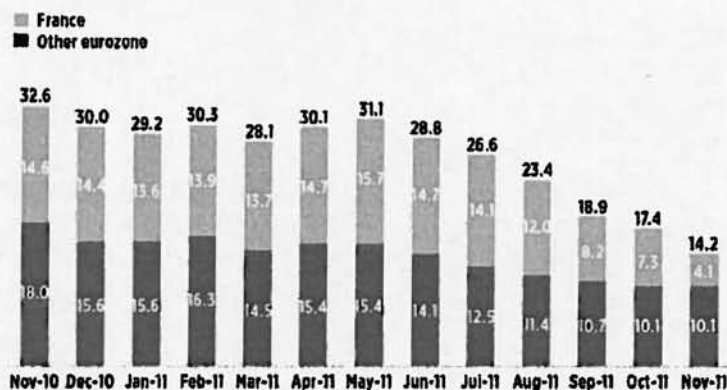
By Sean Collins and Chris Plantier

DECEMBER 16, 2011

Over the last year, U.S. money market funds have significantly reduced their holdings of debt securities issued by banks and other businesses headquartered in the 17 countries that use the euro as their currency. That trend continued in November.

### Prime Money Market Funds' Holdings of Eurozone Issuers

Percentage of prime funds' total assets, end of month



Note: Data exclude prime money market funds not registered under the Securities Act of 1933.

Sources: Investment Company Institute tabulation of publicly available Form N-MFP data prior to May 2011; ICI tabulation of data provided by Crane Data thereafter.

For the first time, ICI is issuing estimates of money market funds' European holdings in dollar terms. We estimate the total exposure of money market funds (including prime and government and agency funds) to European-domiciled issuers to be less than \$800 billion in November. However, as explained below, a sizable fraction of those assets represents repurchase agreements with the U.S. operations of European-headquartered banks, and another portion represents securities issued by entities in European countries outside the eurozone. Taking these factors into account, we estimate that U.S. prime money market funds' holdings of eurozone securities fell to \$204 billion by the end of November.

As we have discussed in [previous posts](#), portfolio managers of U.S. money market funds have effectively zeroed out their direct holdings in the countries most affected by the eurozone government debt crisis. These funds have also gradually trimmed their holdings of issuers in other eurozone countries that might be negatively affected by the debt crisis. As a result of these portfolio adjustments, U.S. money market funds hold virtually no securities issued in Italy, Spain, or the other eurozone "periphery" countries.

Funds' exposure to French-domiciled banks continued to fall sharply in November. Prime money market funds reduced their holdings of French issuers to 4.1 percent of their assets under management in November, down from 7.3 percent in October and the peak level of 15.7 percent in May. As the chart shows, holdings of non-French eurozone issuers remained roughly steady at 10.1 percent in November. Altogether, securities of eurozone issuers accounted for 14.2 percent of total assets of U.S. prime money market funds at the end of November, down from 17.4 percent in October and 31.1 percent in May.

### Dollar Estimates of U.S. Money Market Funds' Exposure

An overall decline in prime money market fund assets since May accounts for some of the shift away from the eurozone. From May to November, prime fund assets declined by \$214 billion. During that period, prime funds' holdings of French assets fell by an estimated \$200 billion, while other eurozone assets declined by an estimated \$109 billion. At the same time, money market funds have increased their holdings of European issuers outside the eurozone. In November, the top three European countries for U.S. prime money market funds' holdings were the UK, Sweden, and Switzerland, none of which use the euro as their currency.

Some commentators have suggested that U.S. money market funds' exposure to Europe totals almost \$1 trillion. This calculation is based on a number of misconceptions:

First, the only way to reach an estimate of \$1 trillion is to apply estimates based on

prime money market funds' European exposure to the total assets for all money market funds. Commentators cite Fitch Ratings Service, which on November 22 estimated that European bank securities comprised 34.9 percent of the assets of the 10 large money market funds in its sample at the end of October. But, as Fitch clearly states, the funds in its sample are all prime funds—and prime funds account for only \$1.45 trillion, or just over half, of total money market fund assets. To approach a \$1 trillion estimate, Fitch's percentage estimate must be applied to the \$2.68 trillion assets of all money market funds, including Treasury funds, U.S. government agency funds, and tax-exempt funds—all of which have far less exposure to European securities than prime funds.

Treasury and government agency money market funds do hold some securities issued by European-domiciled issuers—primarily European-headquartered banks with U.S. operations. We estimate the total exposure of money market funds (including prime and government and agency funds) to European-domiciled issuers to be less than \$800 billion in November.

However, much of that exposure—some \$355 billion—represents short-term repurchase agreements (repos) with European-headquartered banks. The vast majority of these repurchase agreements are collateralized by U.S. Treasury and agency securities that the European banks must pledge.

Finally, much of the European exposure of prime and government money market funds is to issuers *outside* the eurozone, notably to banks in the UK, Sweden, Switzerland, and Norway. Market participants generally view European banks outside the eurozone as somewhat more insulated from the eurozone debt crisis.

Taking all these factors into account, we estimate that the total exposure of U.S. prime and government money market funds to eurozone issuers is \$305 billion, of which almost half is in short-dated repurchase agreements.

#### Prime Money Market Funds' Holdings by Home Country of Issuer

Country	Percentage of total assets	
	May 2011	November 2011
<b>World Total</b>	<b>100%</b>	<b>100%</b>
<b>Europe</b>	<b>53.0</b>	<b>37.2</b>
<i>Eurozone</i>	<i>31.1</i>	<i>14.1</i>
France	15.7	4.1
Germany	7.1	5.1
Netherlands	5.8	4.4
Belgium	0.8	0.3
Austria	0.2	0.2
Spain	0.7	0.0
Luxembourg	0.1	0.0
Italy	0.7	0.0
<i>Non-eurozone</i>	<i>21.9</i>	<i>23.1</i>
UK	11.5	10.8
Switzerland	4.2	5.2
Sweden	4.1	5.5
Norway	1.3	1.3
Denmark	0.8	0.3
<b>Americas</b>	<b>35.0</b>	<b>45.9</b>
USA	27.3	35.1
Canada	7.7	10.8
Chile	0.0	0.0
<b>Asia and Pacific</b>	<b>11.3</b>	<b>16.2</b>
AUS/NZ	6.7	8.1
Japan	4.6	7.9

India	0.0	0.0
Singapore	0.0	0.1
Korea	0.0	0.0
<b>Supranational</b>	<b>0.1</b>	<b>0.1</b>
<b>Unclassified</b>	<b>0.7</b>	<b>0.7</b>

Note: Calculations are based on a sample of 95 funds, representing an estimated 87 to 95 percent of prime funds' assets for May and November, respectively.

Source: Investment Company Institute tabulation of data provided by Crane Data

Sean Collins is ICI's Senior Director of Industry and Financial Analysis and Chris Plantier is an ICI Senior Economist.

*This item was originally posted on December 14. We revised this post on December 16 to incorporate new information on repurchase agreements, to incorporate new testimony on this issue, and to clarify the discussion on recent commentary based on analysis from Fitch Ratings Service.*

### Data Update: Money Market Funds and the Eurozone Debt Crisis

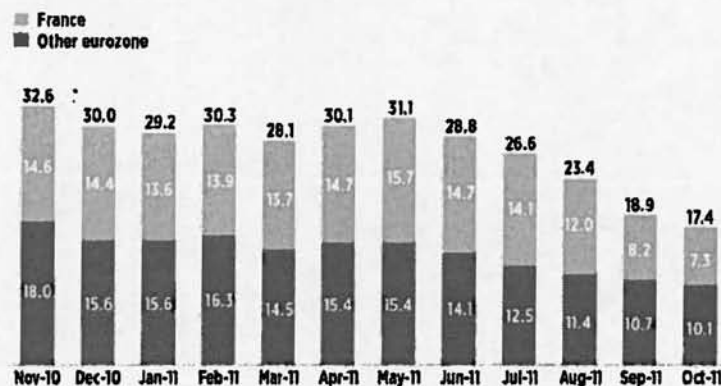
By Sean Collins and Chris Plantier

DECEMBER 02, 2011

In October, we discussed how portfolio managers of U.S. prime money market funds have addressed the ongoing debt crisis in the eurozone. Here is a look at the latest monthly data on these funds' holdings by home country of issuer. We will revisit the topic in mid-December with updated analysis once November figures become available.

#### U.S. Prime Money Market Funds' Holdings of Eurozone Issuers

Percentage of prime funds' total assets, end of month



Note: Data exclude prime money market funds not registered under the Securities Act of 1933.

Sources: Investment Company Institute tabulation of publicly available Form N-MFP data prior to May 2011; ICI tabulation of data provided by Crane Data thereafter

#### Prime Money Market Funds' Holdings by Home Country of Issuer

October 31, 2011

Country	Billions of dollars	Percentage of assets
<b>World Total</b>	<b>\$1,293.1</b>	<b>100%</b>
<b>Europe</b>	<b>512.2</b>	<b>39.5</b>
<i>Eurozone</i>	<i>225.1</i>	<i>17.4</i>
France	94.4	7.3
Germany	64.9	5.0
Netherlands	58.2	4.5
Belgium	4.2	0.3
Austria	2.1	0.2
Spain	0.7	0.1
Luxembourg	0.5	0.0
Italy	0.1	0.0
<i>Non-eurozone</i>	<i>287.1</i>	<i>22.1</i>
UK	132.5	10.2
Switzerland	65.8	5.1
Sweden	63.4	4.9
Norway	19.8	1.5
Denmark	5.6	0.4
<b>Americas</b>	<b>571.3</b>	<b>44.2</b>
USA	449.0	34.7
Canada	121.9	9.4



Chile	0.4	0.0
<b>Asia and Pacific</b>	<b>196.5</b>	<b>15.2</b>
AUS/NZ	102.9	8.0
Japan	93.0	7.2
India	0.6	0.0
Korea	0.0	0.0
<b>Supranational</b>	<b>0.5</b>	<b>0.0</b>
<b>Unclassified</b>	<b>12.6</b>	<b>1.0</b>

Note: Calculations are based on a sample of 95 funds, representing an estimated 89.8 percent of prime funds' assets.

Source: Investment Company Institute tabulation of data provided by Crane Data

For more on money market funds, please visit ICI's [Money Market Funds Resource Center](#).

Sean Collins is ICI's Senior Director of Industry and Financial Analysis and Chris Planter is an ICI Senior Economist.

## Money Market Funds' Prudent Response to European Challenges

By Sean Collins and Chris Plantier

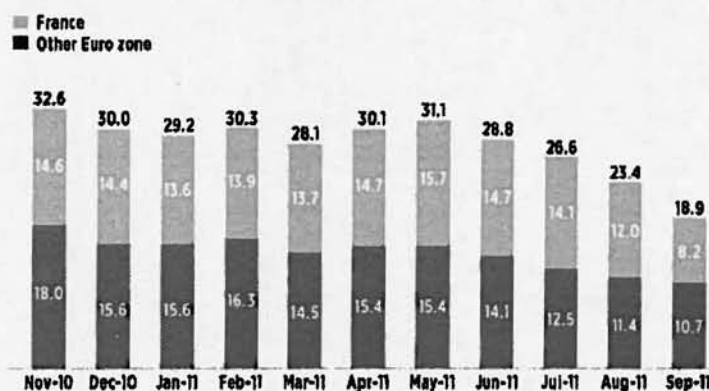
OCTOBER 14, 2011

The ongoing debt crisis in the eurozone poses challenges for portfolio managers of U.S. prime money market funds, as those managers actively continue to adjust their holdings to meet new developments. The latest monthly data on money market funds' holdings demonstrate that these funds are carefully managing their risks in Europe, and have been gradually reducing eurozone holdings for some time now.

New data show that U.S. prime money market funds reduced their exposure to issuers in the eurozone—the 17 countries that use the euro as their currency—by \$54 billion in September. As a result, securities of eurozone issuers accounted for 18.9 percent of total assets of U.S. prime money market funds at the end of September, down from 23.4 percent in August and 26.6 percent in July. As the chart shows, eurozone holdings' share of money market fund portfolios began to decline steadily this summer as credit concerns increased, after remaining fairly stable for several months.

### U.S. Prime Money Market Funds' Holdings of Eurozone Issuers

Percent of prime funds' total assets, end of month



Note: Data exclude prime money market funds not registered under the Securities Act of 1933.

Sources: Investment Company Institute tabulation of publicly available Form N-MFP data prior to May 2011; ICI tabulation of data provided by Crane Data thereafter

But these prudent moves, intended to maintain minimal credit risk in money market funds' portfolios, have opened up a new—and contradictory—complaint: that U.S. money market funds are contributing to the European crisis because their pullback is squeezing banks' funding. For example, Eric Rosengren, President of the Federal Reserve Bank of Boston, in a recent speech, expressed concerns about U.S. money market funds' role in "dollar shortages." And *The Economist* wrote last week that "American money-market funds have almost completely withdrawn dollar funding from European banks over the past few months."

However, the data certainly do not bear out the notion that money market funds have withdrawn all funding from European banks (see table below). And the gradual nature of the reduction suggests that any "shortages" more likely reflect the unwillingness of some European banks to pay higher rates or to offer shorter-term paper as credit concerns mounted. The lack of demand for three-month dollar funds at the tender by the European Central Bank (ECB) this week indicates that eurozone banks are finding other ways to meet their short-term needs for U.S. dollar funding. More generally, U.S. money market funds were just a small part of a months-long, market-wide withdrawal from deteriorating financial conditions and rising credit concerns for eurozone sovereigns and banks.

### Prime Money Market Funds' Holdings by Home Country of Issuer

September 30, 2011

Country	Billions of dollars	Percentage of total assets
World Total	\$1,302.2	100%
Europe	531.2	40.8
Eurozone	245.6	18.9

France	106.7	8.2
Germany	68.8	5.3
Netherlands	58.6	4.5
Belgium	7.6	0.6
Austria	2.3	0.2
Spain	1.1	0.1
Luxembourg	0.5	0.0
<b>Non-eurozone</b>	<b>285.7</b>	<b>21.9</b>
UK	125.6	9.6
Sweden	68.9	5.3
Switzerland	63.9	4.9
Norway	22.9	1.8
Denmark	4.4	0.3
<b>Americas</b>	<b>562.8</b>	<b>43.2</b>
United States	435.9	33.5
Canada	126.6	9.7
Chile	0.3	0.0
<b>Asia and Pacific</b>	<b>197.6</b>	<b>15.2</b>
Australia/New Zealand	103.5	7.9
Japan	93.6	7.2
India	0.5	0.0
Korea	0.0	0.0
<b>Supranational</b>	<b>0.5</b>	<b>0.0</b>
<b>Unclassified</b>	<b>10.0</b>	<b>0.8</b>

Source: Investment Company Institute tabulation of data provided by Crane Data

By design and regulation, U.S. money market funds cannot be a source of long-term funding for European banks or any other issuers. Instead, fund managers are required to invest in high quality, short-term U.S. dollar securities, with an average portfolio maturity of 60 days or less. Managers have a fiduciary duty to manage risks on behalf of their shareholders. Their actions with respect to their eurozone exposures over the past two years have reflected that fiduciary duty.

Let's look in turn at how funds are managing these risks and how that is affecting Europe's banks.

#### **Steadily Reducing European Exposures**

U.S. money market funds' reduction in overall eurozone holdings in September was not a sudden move: they have working down their exposure to eurozone risks for more than a year. ICI surveys show that U.S. money market funds have held no public or private debt from Portugal or Greece since May 2010, and that these funds eliminated any holdings issued by Irish financial institutions earlier this year. Since last winter, money market funds have gradually reduced their exposure to Italian and Spanish banks. Based on Crane data, holdings of Italian and Spanish securities were reduced to zero and \$1.1 billion, respectively, by the end of September.

The data show that funds are also limiting their risks by shortening the maturity of the European securities they hold, focusing their lending on securities that mature in 30 days or less. According to Crane Data, as of the end of September, 60 percent of U.S. prime money market funds' holdings of French issuers will mature in 30 days or less, compared to 37 percent of their holdings at the end of June. Similar but smaller moves were seen in Germany and the UK. Shortening maturities reduces funds' risks, because shorter-dated paper can be redeemed sooner if the issuer's financial condition worsens. Also, shorter maturities help money market fund managers prepare for potential redemptions by fund investors.

These funds' reduced European holdings are driven in part by their own declining assets. Assets in prime money market funds fell \$182 billion from May to September, as fund investors redeemed shares during the period spanning the downgrade of U.S. government debt as well as growing concerns about Europe's finances. When money fund investors redeem shares, fund portfolio managers must shed assets to meet those redemptions. In this case, fund managers chose to reduce

their eurozone holdings.

This response makes sense given the deteriorating financial conditions in the eurozone. Premiums on credit default swaps for top European banks, which measure the market's assessment of the probability of default, widened markedly in August. And on September 14, Moody's Investors Service lowered the long-term debt and deposit ratings on two large French banks—Crédit Agricole and Société Générale. To be sure, Moody's recently reaffirmed the short-term credit ratings—the ratings that apply to the securities money funds hold—of those French banks and a third, BNP Paribas. But money market fund managers are required to look beyond credit ratings in making their determination that securities in their portfolios pose minimal credit risks.

#### **The Impact on European Banks**

These prudent moves to reduce money market fund shareholders' risks have raised concerns in some circles that U.S. money market funds could exacerbate the European banking crisis by squeezing the banks' dollar-denominated funding. But this argument would suggest that investors should not react to evolving credit conditions in the market.

Not surprisingly, money market funds' actions reflect a market-wide reassessment of European risks. Press reports indicate that hedge funds, U.S. banks, and certain sovereign wealth funds have been quietly reducing their exposures in Europe or have been unwilling to engage in derivatives transactions with certain European issuers. Also, banks within Europe have apparently become increasingly unwilling to lend to one another, as evidenced by a widening in the three-month Euribor-Overnight Index Swap spread, which compares the rate on three-month interbank loans in euros to the ECB's expected overnight policy rate. Banks have also substantially increased their deposits at the ECB.

The significant increase in European banks' borrowing from the ECB this summer—especially by Italian and Spanish banks—dwarfed the pullback by U.S. money market funds. From June to August, gross bank borrowing from the ECB in Spain and Italy increased by more than \$100 billion—vastly outstripping the \$19 billion reduction in money market funds' lending to these banks over the same period. The ECB's recent interventions in the Italian and Spanish government bond market further suggest that the withdrawal from Italy and Spain involved far more lenders than just U.S. money market funds.

#### **Summing Up**

Money market fund managers, faced with a fiduciary duty to manage risks on behalf of their shareholders and a deteriorating financial situation in Europe, have prudently reduced the amount and shortened the average maturity of their holdings of securities issued by European governments, banks, and other issuers. In doing so, funds are part of an ongoing market-wide reassessment of the current risks of investing in Europe.

Sean Collins is ICI's Senior Director of Industry and Financial Analysis and Chris Plantier is an ICI Senior Economist.

## Déjà vu—U.S. Money Market Funds and the Eurozone Debt Crisis

By Chris Plantier and Sean Collins

SEPTEMBER 12, 2011

In June, we wrote about the indirect exposure that U.S. prime money market funds have to European sovereign debt, especially Greek debt, through their holdings of securities issued by European banks. At that time, we noted that these funds had no direct exposure to Greek sovereign debt, and that they were managing their indirect exposure by constantly examining the quality of their portfolio and the creditworthiness of investments. By July 1, we could report that U.S. prime money market funds had no direct exposure to Portuguese or Irish government or bank debt.

Since then, U.S. prime market funds have continued their careful monitoring and risk management on their portfolios. They have reduced their direct exposure to issuers in Italy and Spain to virtually zero, and have shortened maturities for their holdings of core European banks. Overall, U.S. prime money market funds remain well positioned to respond to potential developments in Europe. Some specifics:

**Any likely downgrades in the long-term credit rating of large French banks would not affect money market funds' ability to hold these banks' short-term securities.** Under Securities and Exchange Commission regulations, money market funds are required to hold short-term, highly liquid, high quality securities, with the vast majority of their assets in "First Tier" securities, those with the highest short-term rating. Moody's Investor Service or other credit rating agencies may well decide to lower the long-term ratings for large French banking groups by one or possibly two notches. However, even a two-notch downgrade would leave the banks' short-term paper in the First Tier, and would not change those securities' status as eligible investments for money market funds. (For more on eligible securities for money market fund investment, see our FAQs.)

**Direct exposure to both public and private issuers in the European "periphery" countries is virtually zero.** Since June, U.S. money market funds have almost eliminated holdings of Italian and Spanish government and private debt, including bank securities.

**U.S. money market funds have reduced the maturity of their holdings in banks in Europe's "core" (France, Germany, the United Kingdom, and other countries).** According to JP Morgan Securities, 60 percent of U.S. prime money market funds' holdings in French banks as of the end of August will mature in 30 days or less, compared to 28 percent of their holdings at the end of June. Shorter maturities provide flexibility and reduce the impact of any potential downgrades.

According to Crane Data, at the end of July, 69 percent of money market funds' holdings in German banks and 67 percent of holdings in British banks were set to mature in 30 days or less.

**U.S. prime money market funds have increased their liquidity this summer.** As the August 2 deadline for raising the U.S. debt ceiling approached, U.S. money market funds generally increased the share of their portfolios held in highly liquid securities (cash, Treasury and some other government securities, and other securities that mature or can be converted to cash within five business days). For prime money market funds, assets liquid within one week rose to 40 percent of portfolios on August 2 from 32 percent on June 21, according to iMoneyNet. One-week liquidity stood at 38 percent as of September 6. This increased liquidity allows prime funds to meet any increased redemptions associated with policy or market uncertainty in the U.S. and Europe.

**Prime money market funds remain well positioned to respond to potential developments in Europe.** Money market fund managers have been carefully monitoring and managing their exposure to European debt risks. Also, the core European banks are large, profitable banks, and all have access to liquidity facilities from the European Central Bank.

*Update: On September 14, Moody's Investors Service reaffirmed Prime-1 short-term ratings at three large French banks. See Moody's comments regarding Crédit Agricole, Société Générale, and BNP Paribas. For Crédit Agricole and Société Générale, Moody's lowered the long-term debt and deposit ratings by one notch.*

Chris Plantier is an ICI Senior Economist and Sean Collins is ICI's Senior Director of Industry and Financial Analysis.



## The Debt Ceiling Debate and Its Impact on Money Market Funds

By Chris Plantier and Sean Collins

AUGUST 04, 2011

Data on money market funds flows continue to draw attention, especially with today's report that net outflows totaled \$66 billion in the week ending August 3. As ICI Chief Economist Brian Reid explained last week, several factors have been influencing recent flows. His analysis found that the standoff over the U.S. debt ceiling, concerns about Eurozone debt, and recent regulatory changes are among the major factors that could be affecting investors.

While it's still difficult to sort out which of these factors is having the most impact on the flows during the last three weeks, the weekly and daily data from July 27 to August 3 indicate that uncertainty about the debt ceiling was the primary force affecting money market fund assets during the past week. Taking a closer look at the data—both ICI's weekly figures and daily numbers from other providers—offers some indications of the effect of the August 2 deadline for raising the U.S. government's debt ceiling and the tense days of uncertainty that preceded the debt-and-deficit agreement signed by President Obama by the deadline.

ICI's weekly data show money market funds held roughly \$2.6 trillion in assets as of August 3. That reflects \$66 billion in net outflows from all types of money market funds during the past week—more than is typical at this time of year—with \$77 billion flowing out of institutional money market funds. By contrast, retail money market funds saw inflows of \$11 billion in the week ending August 3.

It appears that a large amount of this week's net outflow was related to concerns over the U.S. debt ceiling negotiations. That's supported by daily data from Crane Data Money Fund Intelligence for the same week, which show that institutional money market funds posted outflows on July 28, 29, and August 1. These funds then gained small inflows on August 2 and 3 once it was clear that the debt ceiling would be raised.

What might be overlooked in a focus on the data is just how well money market fund managers prepared for and managed another period of market stress. The past week's net outflows amounted to almost 5 percent of the total assets of institutional money market funds. The 2010 SEC amendments to money market fund regulations require funds to hold at least 30 percent of their assets in securities that will be liquid within five business days—a buffer that makes money market funds much more resilient when faced with redemptions. And money market fund managers have operated their funds above and beyond SEC requirements during this time of potential stress. For example, data from iMoneyNet show that, as of July 26, government money market funds held approximately 63 percent of their assets in securities that would mature within one week.

In summary, recent money market fund flows continue to reflect the uncertain and fluid nature of U.S. and global markets and events. Throughout this period, money market fund managers continue to manage portfolios to ensure they are positioned to weather these storms.

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Chris Plantier is an ICI Senior Economist, and Sean Collins is ICI's Senior Director, Industry and Financial Analysis.

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## It's Highly Unlikely that Money Market Funds Will 'Break the Dollar' in U.S. Debt Crisis

By Chris Plantier and Sean Collins

JULY 29, 2011

The continuing impasse over the U.S. government's borrowing limit—the "debt ceiling"—and efforts to rein in the growth of federal debt has raised many questions for investors in all types of financial assets. ICI believes that money market funds are no more vulnerable to these events than other assets: As ICI Chief Economist Brian Reld wrote yesterday, "I don't know of any scenario in which money market funds would be disproportionately affected compared to other market participants by a failure to raise the debt ceiling."

However, to increase public understanding and address investor concerns, *ICI Viewpoints* has addressed recent trends in flows to and from money market funds and whether money market funds would be forced to sell their U.S. government securities in the event of a credit-rating downgrade or default.

Now, some people are asking whether a U.S. government downgrade or default would drive down the value of money market fund assets to the point where funds would "break the dollar"—be unable to maintain their stable \$1.00 per-share net asset value.

Our analysis suggests that's highly unlikely. Money market funds have always operated under strict regulations, and those rules were tightened in 2010. In practice, managers are exceeding the rules' standards for safety. For example, government money market funds are carrying almost twice as many liquid assets as the current standards require, and they've shortened their portfolios considerably. For these reasons, the chances that a downgrade or default would force money market funds to break the dollar seem remote.

Bear with us as we explain.

In January, ICI published a comprehensive study of how market forces affect the mark-to-market net asset values (NAVs) of money market funds.

That paper identified four factors that are primarily responsible for changes in a money market fund's per-share market value:

- changes in interest rates;
- the maturity of the fund's portfolio;
- net flows of new money into or out of the fund; and
- credit events affecting securities in the fund's portfolio.

Our paper showed that large changes in these factors are necessary to force a money market fund to break the dollar, i.e., see its mark-to-market value fall below \$0.9950. Even in the event of a downgrade, such extreme changes are highly unlikely.

Let's look at each of these factors.

**Changes in interest rates:** Either a downgrade or a default would be likely to increase the market's perception of risk in U.S. government debt and lead to higher interest rates. Higher rates, in turn, drive down the market value of securities already held in a fund's portfolio.

Rating agencies and market analysts have suggested that rates on U.S. Treasury securities might rise anywhere from 25 to 70 basis points in the event of a credit rating downgrade. That's not enough to force money market funds to break the buck. Our January study found that a 100 basis point increase in interest rates would reduce money market funds' per-share market value by only 17 basis points, to \$0.9983. Indeed, it takes a rapid 300 basis point rate increase on every security in a fund's portfolio to drive the fund's per-share market value to \$0.9950.

**The maturity of the fund's portfolio:** The longer a portfolio's dollar-weighted average maturity (WAM), the greater the impact of changing interest rates on the fund's per-share market value. The calculations in the previous paragraph, for example, are based on a fund with a 60-day WAM—the maximum maturity allowed under the 2010 amendments to the SEC's Rule 2a-7.

In fact, government money market funds have been reducing their maturities. According to data from *JMoneyNet*, the WAM for government money market funds was less than 45 days in late July. Our January study showed that a fund with a 45-day WAM can withstand a 400 basis point rate increase before its per-share market value falls to \$0.9950.

**Net flows of money out of the fund:** Heavy redemptions from a fund can magnify any existing

showed that even when interest rates and flows are both working in the same direction, a fund's per-share market value may not move very much.

Let's say there's a 100 basis point increase in interest rates. A fund would have to experience redemptions of almost 70 percent of its assets to see its per-share market value fall below \$0.9950. That's not very likely: redemptions have exceeded 60 percent of taxable money market fund assets in only 0.06 percent of the weeks between April 1996 and December 2010.

A fund can counter the impact of heavy redemptions by keeping its portfolio very liquid. If the fund has securities with very short maturities, it can meet redemptions without forced sales of securities that might have dropped in value. The SEC recognized this in its Rule 2a-7 amendments, when it required taxable funds (including government funds) to hold 10 percent of their assets in cash or securities that are liquid within one day, and 30 percent of assets in securities liquid within five business days.

In fact, government funds are far exceeding those standards: On June 30, the average government fund had 58 percent of its assets in securities that would mature within five business days, according to iMoneyNet.

**Credit events affecting securities in the fund's portfolio.** A downgrade in the U.S. government debt would, of course, be a "credit event"—an unprecedented credit event. The impact of that event would depend on the market's reaction as expressed through changes in interest rates on U.S. government securities. As discussed above, the interest rate impact that most market analysts anticipate would not be large enough to force money market funds to break the dollar.

As discussed in our [FAQs on money market funds and the debt ceiling](#), if the U.S. government failed to pay interest or principal when due on a security in a money market fund's portfolio, the fund must dispose of the security in an orderly manner, unless the fund's board determines that disposing of the security would not be in the best interests of the fund and its shareholders. The board may consider market conditions, among other factors, in making that decision. In unsettled markets following a default on U.S. government securities, a board may determine that disposal of its U.S. Treasury securities would not be in the best interests of the fund or its shareholders, particularly if the default promised to be of short duration.

**The bottom line.** Along with other market participants, money market fund managers are facing challenging and dynamic market conditions. Fortunately, these managers have been looking far ahead and appear to have been preparing their funds for these conditions. Their decisions seem prudent and reflective of the markets in which they operate. For those reasons, the chances that a downgrade or default would force money market funds to break the dollar seem remote.

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Chris Pantier is an ICI Senior Economist, and Sean Collins is ICI's Senior Director, Industry and Financial Analysis.

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## What's Happening with Recent Money Market Fund Flows?

By Brian Reid

JULY 28, 2011

Statistics on money market funds inflows and outflows are currently a hot topic in the financial world, so it's a good time to dig into the data and see if we can help explain the latest trends.

Money market funds today hold roughly \$2.6 trillion in total assets. During the past two weeks, ICI data show \$62 billion in total outflows from these funds—more than we would expect to see due to seasonal flows. The past two weeks' numbers are appreciably larger than the flows recorded in most prior weekly reports this year.

What accounts for the bump? Looking at the data, we believe there are five factors in play. The convergence of these factors and the fluid nature of the markets make it impossible to know which causes are having the biggest impact on outflows—but they are all worth exploring.

Obviously, one factor we can't rule out is that investor concerns about Congress's inability to reach an agreement on the federal debt ceiling may be contributing to the outflows. While the impasse over the U.S. debt ceiling has prompted some questions about the implications for money market funds, we believe those concerns are overstated. I don't know of any scenario in which money market funds would be disproportionately affected compared to other market participants by a failure to raise the debt ceiling. But, like all others in the asset management business, money market fund managers are preparing for market volatility that could arise if Congress doesn't act. Managers are making their funds more liquid and turning to shorter term instruments to prepare.

Four other factors may also be important in explaining the outflows during the past few weeks. First, the extended period of historically low interest rates has led to low yields on money market funds. During the past two years, some investors have shifted their cash to other investment vehicles in search of higher yield. Others may be moving to bank deposits.

Two other factors result from recent changes that are part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Beginning in January, the Federal Deposit Insurance Corporation began to provide unlimited insurance to non-interest bearing checking accounts. In this low-rate environment, some investors may be choosing to park their cash in such checking accounts for the federal guarantee. During the past eight months, Federal Reserve Board statistics show that demand deposit balances have increased by nearly 20 percent, to more than \$601 billion. In comments to regulators, ICI has described the new systemic risks this rule change could present.

The other regulatory change is that for the first time since the Great Depression, banks are allowed to pay interest on business checking accounts. This change went into effect on July 22, and in the past two weeks we have observed heavier-than-usual outflows from money market funds.

Finally, lingering concerns about the European debt crisis and its potential impact on prime money market funds may have also fueled investor concerns in the last two weeks. In fact, prime money market funds experienced a \$24 billion outflow over the last two weeks, accounting for 38 percent of the total outflow from money market funds.

Given the fluid nature of markets and events, we cannot know which of these five factors is having the most impact in the larger-than-expected outflows from money market funds. We do know that money market fund managers are facing challenging and dynamic market conditions. Fortunately, their decisions seem prudent and reflective of the markets in which they operate.

Brian Reid is ICI's Chief Economist.



## Debt Ceiling Scenarios: ICI Addresses Key Questions Regarding Possible Impact on Money Market Funds

By Karrie McMillan and Brian Reid

JULY 20, 2011

As Paul Schott Stevens wrote on ICI Viewpoints earlier, a downgrade or default of U.S. Treasury securities would have grave implications for investors, markets, and economies around the world. This prospect raises a number of questions for funds and their shareholders, particularly for money market funds. We've prepared a set of "frequently asked questions," focused on money market funds, to further address the key issues and dispel some of the uncertainty produced by this unprecedented policy situation.

For example, what would be the impact for U.S. money market funds of a downgrade in the credit rating of U.S. sovereign debt (debt issued by the U.S. Treasury or government agencies)?

One of the most important factors is whether any downgrade affects only the U.S. government's long-term credit rating, or applies to both long-term and short-term debt. A money market fund's ability to purchase or hold a rated security depends on the issuer's short-term credit rating.

Most of the discussion to date has focused on downgrades to the AAA/Aaa rating on the United States' long-term debt. **However, unless the major credit rating agencies also downgrade short-term debt issued by Treasury and other federal agencies, money market funds would not be affected by any change in the AAA/Aaa rating.**

It's important to note that long-term and short-term ratings don't move in lockstep. Further, credit rating agencies would have to cut their ratings on short-term U.S. government securities steeply—by an amount roughly equivalent to eight steps on the long-term rating scale. None of the major credit rating agencies has discussed a downgrade of U.S. government debt of that severity.

We invite you to read the full FAQs, which also cover the following questions:

Would a downgrade in the short-term credit rating for U.S. sovereign debt force money market funds to dispose of their holdings of U.S. government debt?

What credit ratings correspond to First Tier and Second Tier for money market funds?

Are there credit factors other than ratings that money market funds must consider when buying or holding securities?

Would money market funds be able to add U.S. government securities to their portfolios if the U.S. government's short-term credit rating falls to Second Tier?

In the unlikely event that short-term U.S. sovereign debt were downgraded below Second Tier, what would money market funds be required to do?

What would be the consequences of failure by the U.S. Congress and Administration to raise the debt ceiling by August 2, 2011?

For a money market fund, what would constitute "default" in a U.S. government security?

Why might a money market fund's board of directors choose not to dispose of a defaulted or severely downgraded security?

For the sake of investors, policymakers must quickly resolve the matter of the debt ceiling while addressing our nation's longer-term deficit challenges. ICI will continue to follow this issue and to provide information to help people assess the potential impact of these developments on money market funds or other matters of concern to investors.

Karrie McMillan is General Counsel and Brian Reid is Chief Economist of the Investment Company Institute.



## Dispelling Misinformation on Money Market Funds

By Brian Reid

JULY 01, 2011

The ongoing attention to U.S. prime money market funds' exposure to the debt crisis in Greece has brought three questions to the fore:

Are U.S. money market funds invested in the "periphery countries"—Greece, Italy, Spain, Portugal, and Ireland—that are seen at risk in a debt crisis?

Why are U.S. money market funds investing in European banks?

What risks do those investments pose for U.S. money market funds and their investors?

The answers to those questions can be summed up in four points:

U.S. prime money market funds have no direct exposure to Greek, Portuguese, or Irish government or bank debt. Their holdings of Spanish and Italian bank debt are minimal and have fallen substantially since last autumn.

U.S. money market funds have plenty of sound reasons to invest in large, well-capitalized banks with extensive U.S. and global operations—whether those banks are headquartered in the U.S. or Europe.

It would take a rapid collapse of one or more large European banks to have any impact on U.S. money market funds and their investors. The market is not anticipating any such collapse.

Regulators and money market funds themselves have put greater safeguards in place to strengthen these funds since the financial crisis.

Those are the facts. Unfortunately, there's been a lot of misinformation and misunderstanding surrounding these matters. To clear the air, I've written a detailed [article](#) for ICI's Money Market Fund Resource Center. I hope you'll take a look.

Brian Reid is ICI's Chief Economist

## Money Market Funds and European Debt: Setting the Record Straight

By Sean Collins and Chris Plantier

JUNE 20, 2011

Recent events in Greece have drawn the media's attention to indirect exposure that U.S. money market funds may have to European sovereign debt through their holdings of securities issued by European banks. Unfortunately, some of those stories have landed far from the mark and require correction. Here are some of the facts that the media is missing:

**1. A recent Moody's Investor Service announcement regarding certain French banks reaffirms the highest rating for those securities that money market funds hold.** While Moody's recently announced it is reviewing the long-term ratings for three French banking groups, the same announcement reaffirmed Moody's highest rating on those banks' short-term paper. Thus, any exposure that U.S. money market funds have to these French banks is deemed of the highest short-term credit quality. Under U.S. Securities and Exchange Commission regulations money market funds are required to hold the vast majority of their assets in short-term securities that have received the highest short-term rating.

**2. Comparisons between Lehman Brothers in 2008 and French banks in 2011 are misleading and inappropriate.** French banks have much higher required capital ratios than Lehman Brothers did in 2008. These are large, profitable banks, and their direct exposure to Greek government debt is a small fraction of their capital. Also, French banks have access to liquidity facilities from the European Central Bank.

**3. U.S. money market funds have no direct exposure to Greek sovereign debt, and they have managed and continue to manage any indirect exposure.** The Eurozone has been experiencing debt and financial concerns for more than a year now. Throughout this period, prime money market funds and other investors have reacted to changing developments. As fiduciaries to their shareholders, money market funds are constantly examining the quality of their portfolio and the creditworthiness of investments—going above and beyond any credit rating agency ratings. Over time, this analysis has led prime money market funds to reduce their exposure to certain European sectors and names.

**4. Money market funds are more resilient today than they were in 2008.** In 2010, the SEC amended regulations that raised these funds' standards for credit quality, shortened portfolio maturities, improved disclosure, and imposed for the first time explicit liquidity requirements for fund portfolios.

**5. The safety of money market funds derives from their holdings of low-risk, liquid assets, not from a government guarantee.** Some media reports have compounded their errors on the Eurozone crisis by incorrectly reporting that money market funds carry some sort of government guarantee. Let's be clear: Money market funds have never been backed by the Federal Deposit Insurance Corporation, and they are not now backed by any governmental agency, explicitly or implicitly. In 2008, the U.S. Treasury put into place a temporary guarantee program for money market funds, to help calm the markets. That program expired in 2009 after collecting \$1.2 billion in fees without paying a single claim. Money market funds make clear in prospectuses, advertisements, and on their websites that they are not guaranteed and there is risk of loss of principal. Money market funds are a low-risk investment, but not a no-risk investment.

Learn more about [money market funds](#).

Sean Collins is ICI's Senior Director, Industry and Financial Analysis, and Chris Plantier is an ICI Senior Economist.