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August 20, 2012

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549-1090

Re: President's Working Group Report on Money Market Fund Reform Options (File No. 4-619)

Dear Ms. Murphy:

As the Securities and Exchange Commission continues to contemplate additional regulation of money market funds, we offer for your consideration the attached series of recent *ICI Viewpoints* posts relating to these funds. These posts, available on ICI's website, express the Institute's view that a number of misstatements and misconceptions have, unfortunately, entered the important discussion around money market funds. These posts address the following topics:

- The "Susceptible to Runs" Myth (August 12)
- The False Narrative of 2008 (August 13)
- What Money Market Fund Investors Know (August 14)
- Investor Protections in the SEC's 2010 Money Market Fund Reforms (August 15)
- The Power of the SEC's 2010 Money Market Fund Reforms (August 16)

All *ICI Viewpoints* posts 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

INVESTMENT COMPANY INSTITUTE®

Correcting the Record on Money Market Funds

By Mike McNamee

August 12, 2012

Bad information can't give rise to good policy. Unfortunately, the regulators who are campaigning for structural changes in money market funds are building their case on information that is deeply flawed at best.

In testimony, speeches, and other statements, officials from the Securities and Exchange Commission (SEC), the Federal Reserve, and other agencies have made assertions about money market funds that distort the record, exaggerate the impact of these funds on the financial crisis, and reveal profound misunderstandings about money market funds, their investors, and their role in the financial markets. These misstatements aren't just incidental mistakes—they're the foundation of the regulators' case for fundamental changes to a vital financial product. As scores of comments filed with the SEC have documented, those changes would severely damage the value of money market funds for investors and the economy.

Because we believe the truth can trump misinformation, we're going to use this space to correct the record, focusing primarily on SEC Chairman Mary Schapiro's latest testimony before the Senate Banking Committee. Sadly, there are a lot of misstatements. Let's start with the myth that money market funds are "susceptible" to runs.

Misstatement: Money market funds are "susceptible today to investor runs."

Chairman Schapiro spelled out this myth in more detail in a speech last February, when she said: **"Funds remain vulnerable to the reality that a single money market fund breaking of the buck could trigger a broad and destabilizing run."**

In the 40-year history of money market funds, two funds have "broken the dollar," or failed to maintain their stable $1.00 net asset value. In one case—in September 2008—investors did pull back from other prime money market funds. In the other—in 1994—the world yawned because there was no impact on other funds or the markets.

That 50/50 record hardly suggests that money market fund investors are prone to running. Something else must have happened in 2008.

Well—you might say so. September 2008 was the peak of a financial firestorm that Federal Reserve Chairman Ben Bernanke has called "the worst financial crisis in global history, including the Great Depression." At least 13 major financial institutions went bankrupt, were taken over, or were rescued in the 12 months before Lehman Brothers was allowed to fail on September 15, triggering Reserve Primary Fund to break the dollar on September 16. That same day, American International Group (AIG) collapsed and was rescued—demonstrating that even investment-grade firms were at risk and sowing further doubt about the government's stop-and-go stance on rescuing financial giants.

In this maelstrom, investors everywhere reacted to the widespread uncertainty over the stability of financial institutions and the lack of predictable government responses by fleeing from securities issued by financial institutions. Investors pulled about $300 billion from prime money market funds, which held such securities. But those investors didn't run from money market funds. For every dollar that left prime funds, 61 cents went into Treasury and government and agency funds. It was a classic flight to quality—and money market funds were the vehicle of choice for fleeing investors.

And in 1994—the *only other time* a money market fund broke a dollar? There were no ripples when Community Bankers U.S. Government Money Market Fund broke the dollar. Investors did not run from other money market funds—in fact, fund assets *grew* during the next month. The crucial difference: there was no banking crisis and there was no chaotic government response. Absent a broader crisis, the failure of a money market fund had no impact on investors in other funds or the financial system as a whole.

The dictionary defines *susceptible* as "easily influenced…likely to be affected." The fact that only two funds have failed in 40 years would suggest that money market funds are not "easily" broken. And the fact that investors only pulled back from one class of funds in the midst of a raging financial crisis would suggest that they are neither "easily influenced" nor "likely to be affected." The notion that money market funds are "susceptible to runs" is a myth.

Misstatement: "Finally, money market funds offer shares that are redeemable upon demand, but invest in short-term securities that are less liquid. If all or many investors redeem at the same time, the fund will be forced to sell securities at fire sale prices, causing the fund to break a dollar, but also depressing prevailing market prices and thereby placing pressure on the ability of other funds to maintain a stable net asset value."

Once again, Chairman Schapiro's testimony promotes the notion that money market funds are a crisis waiting to happen. If there had ever been any evidence for that idea—and the funds' 40-year record of stability argues otherwise—it certainly isn't true now.

One of the most puzzling aspects of regulators' campaign for changes to money market funds is their steadfast and willful refusal to acknowledge the dramatic improvements in these funds resulting from the SEC's 2010 amendments to Rule 2a-7, the regulation governing these funds. Let's look at how these reforms affect money market funds' ability to meet shareholder redemptions and avoid fire sales.

Since 2010, taxable money market funds are required to hold at least 10 percent of their portfolios in assets that can be turned into cash that day, and 30 percent in assets that are liquid within a week. The 2010 reforms also reduced funds' maximum weighted average maturity to 60 days, with a weighted average life of 120 days or less.

These changes have sharply increased money market funds' ability to manage large fluctuations in investor flows. In practice, money market fund managers have kept their portfolios even more liquid than the requirements. For example, in April 2012, prime money market funds held 29 percent of their portfolios in daily liquid assets and 44 percent in weekly liquid assets. In dollar terms, that means these funds have liquid assets that are twice the size of the outflows prime funds experienced during the week that Lehman Brothers failed.

Regulators' case for structural changes to money market funds is rooted in the notion that money market fund investors are prone to running from these funds at the first sign of trouble. Short of a repeat of "the worst financial crisis in global history," there's scant evidence to support that idea.

Mike McNamee is Senior Director, Public Communications, at ICI. This post reflects analysis by Jane G. Heinrichs, Senior Associate Counsel, and Sean S. Collins, Senior Director, Industry and Financial Analysis.

Correcting the Record: Uncovering Regulators' False Narrative of 2008

By Mike McNamee

August 13, 2012

The regulators who are campaigning for structural changes in money market funds are building their case in part on distortions, exaggerations, and misunderstandings about money market funds, their investors, and their role in the financial markets. Given what's at stake—the grave damage that funds, their investors, and the economy would suffer if concepts promoted by some at the Securities and Exchange Commission (SEC) go forward—it's crucial that the record be clear and accurate.

Today, we're looking at a set of myths that have embedded themselves firmly in regulators' statements—the false narrative of the 2008 financial crisis. The farther we get from those events, the more determined regulators are to claim that money market funds were at the center of the crisis—a tale that, at best, is incomplete and misleading.

Misstatement: Money market funds' "retreat from [the short-term] markets [in September 2008] caused them [the markets] to freeze."

That's how SEC Chairman Mary Schapiro put it in her latest testimony before the Senate Banking Committee. Another version of the myth, from the *2012 Annual Report* of the Financial Stability Oversight Council (FSOC): "structural features of money market funds…*caused a run on prime money market funds and the freezing of the short-term credit markets* after the Reserve Primary Fund was unable to maintain a stable net asset value in September 2008." [emphasis added]

The notion that money market funds *caused* short-term credit markets to freeze conveniently ignores altogether the context of those events—what Federal Reserve Chairman Ben Bernanke has described as "the worst financial crisis in global history, including the Great Depression." This crisis had reached a critical stage long before September 2008: at least 13 major institutions had gone bankrupt, been taken over, or been rescued during the 12 months before Lehman Brothers was allowed to fail, triggering Reserve Primary's problems. The credit markets started to seize up on September 15—before Reserve Primary Fund failed. On the same day that Reserve Primary broke the dollar, American International Group (AIG) collapsed and was rescued—signaling that even investment-grade firms could fail almost without warning. Following these events, concerns rapidly spread in financial markets that the debt of numerous other large investment and commercial banks posed much greater risk than previously thought.

In this maelstrom, investors everywhere reacted to the widespread uncertainty over the stability of financial institutions and the lack of predictable government policy responses to a crisis gripping the global banking system. Money market funds and their investors were neither the first nor the largest of these retreating investors—they were simply among the most easily observable market participants.

Data clearly demonstrate that money market funds were *not* the primary source of pressure in the commercial paper market in September 2008. During that month, outstanding commercial paper declined by $185 billion. ICI data show that money market funds reduced their holdings of commercial paper by $164 billion in September. However, between September 22 and October 1, 2008, the Federal Reserve's Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) program acquired $152 billion in commercial paper—every dollar of which came from money market fund sales to commercial banks. Net of their sales to AMLF, which were designed by the government to pump cash into the market, money market funds accounted for just $12 billion, or about 6 percent, of the $185 billion decline in outstanding commercial paper. Other investors clearly were pulling back from commercial paper issuers in a stressed market.

Elsewhere in the short-term markets, it's clear that a variety of market participants were pulling back their exposures to financial institutions, particularly banks. Banks' borrowing from the Federal Reserve's discount window, excluding the commercial paper programs and lending associated with AIG and Bear Stearns, rose from $170 billion as of September 10, 2008, to $587 billion as of December 17, 2008, and remained at that level through the end of 2008 as other participants withdrew funding from banks.

Banks also quit lending to each other. Interbank lending by commercial banks fell more than 30 percent, or nearly $145 billion, on a seasonally adjusted basis. The stresses were reflected in the spread between the three-month London Interbank Offered Rate (LIBOR) and the overnight index swap (OIS) rate, a traditional measure of the health of the banking sector. The LIBOR-OIS spread jumped from less than 100 basis points on September 12, 2008, to nearly 370 basis points one month later, as banks ceased to lend to each other. (We now know that, if anything, the LIBOR-OIS spread may have *understated* the pressures in the banking system, based on recent reports that certain banks participating in the LIBOR survey were underreporting their funding costs.)

What hit the short-term credit markets in September 2008 was a flight to safety—that is, a near-universal retreat by all investors from securities issued by financial institutions. Charges that money market funds caused those markets to freeze are a startling mischaracterization of that time of crisis.

Misstatement: The "Treasury Department temporarily guaranteed the $1.00 share price of more than $3 trillion in money market fund shares."

This statement from Chairman Schapiro's testimony implies that Treasury put $3 trillion at risk. That's an exaggeration.

The Treasury's Temporary Guarantee Program for Money Market Funds (TGP) was designed to cover losses in funds that signed up and paid fees to participate. The structure of the program ensured that losses, if there were any, would be a miniscule portion of the total assets of participating funds. The reason: if a participating fund's value dropped by just 0.5 percent, the TGP rules required the fund to liquidate and pay off its investors, with the TGP covering any losses up to a preset industrywide limit. The sharp trigger and preset limit would help hold losses to far less than the $3 trillion that Chairman Schapiro and others have suggested.

As it happened, the TGP expired on September 18, 2009, without receiving a single claim. Instead, Treasury—and, as a result, taxpayers—received an estimated $1.2 billion in fees paid by participating money market funds. Other than that one-year program, money market funds have never been insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency—as these funds' investor disclosures and advertisements clearly state. No such guarantee is in place today.

What's interesting is that the official rhetoric about money market funds' role in the financial crisis has become even more shrill with the passage of time. The *2011 Annual Report* for FSOC, for example, said that these funds "added considerably to market stress." Now, in FSOC's 2012 report, regulators have promoted money market funds to the *cause* of all that market stress—without providing any evidence to support that claim.

For more on regulators' false narrative of 2008, please see "Changes in Money Market Oversight Must Be Based on Fact, Not Fiction" in the August 13 issue of InvestmentNews.

This is the second ICI Viewpoints *posting on myths and misstatements about money market funds. The previous entry:*

- Correcting the Record: The "Susceptible to Runs" Myth

Mike McNamee is Senior Director, Public Communications, at ICI. This post reflects analysis by Jane G. Heinrichs, Senior Associate Counsel, and Sean S. Collins, Senior Director, Industry and Financial Analysis.

Correcting the Record: What Money Market Fund Investors Know

By Mike McNamee

August 14, 2012

U.S. money market funds are one of the most transparent financial products on the planet. At just about every opportunity—in advertisements, in formal disclosures, and in shareholder communications—money market funds clearly tell investors that these funds are investment products and carry no guarantees, either from the government or from fund sponsors. And money market fund investors tend to be savvy and knowledgeable about risks. After all, 65 percent of money market fund assets are held in institutional share classes.

But regulators, now campaigning for structural changes in money market funds, find it convenient to question the effectiveness of disclosure and investors' ability to recognize and manage risks. Instead, in their public statements, officials from the Federal Reserve and the Securities and Exchange Commission (SEC) portray investors as confused and misled.

To ensure that debate over money market funds is based in facts and not myths, we're checking and correcting regulators' arguments about money market funds. We're focusing primarily on SEC Chairman Mary Schapiro's latest testimony before the Senate Banking Committee, including this statement:

Misstatement: "Recurrent sponsor support has taught investors to look beyond disclosures that these investments are not guaranteed and can lose value. As a result, when a fund breaks a dollar, investors lose confidence and rush to redeem."

It's contradictory to suggest in one sentence that investors are oblivious to risks, and then to say in the next that investors are prone to panic. But that's just one of the problems in this misstatement.

A bigger issue is that the SEC has produced no evidence to support this account of investor behavior. There's no sign in the Commission's statements or public record that the SEC has surveyed money market fund investors, gauged their attitudes, or analyzed their behavior.

Others, however, have filled that gap—and their findings lend little support to the notion that money market fund investors are ignorant of risks or believe that money market funds are guaranteed. Surveys by Fidelity Investments, for example, found that 75 percent of retail investors know that the government does not guarantee money market funds, and fewer than 10 percent think the government would step in to preserve a fund's $1.00 net asset value (NAV). Instead, four out of five investors knew that securities held by money market funds fluctuate in value, and 83 percent recognize that money market fund investments carry as much or more risk as bank accounts.

Institutional investors—corporations, state and local governments, financial firms, retirement plans, and others—are deeply informed, given the role money market funds play in their daily operations. Indeed, Nancy Kopp, treasurer of the State of Maryland, testifying at the same hearing, chided Chairman Schapiro for treating institutional investors like "children" (video, at 1:21:44 mark).

It also turns out that Chairman Schapiro's statement embodies a strong dose of revisionist history, because the SEC traditionally has defended disclosure and investors' understanding of money market funds—even when sponsor support for money market funds is at issue.

In 1996, the Commission adopted a new rule (Rule 17a-9) to permit fund sponsors to buy portfolio securities from their money market funds—normally barred as an affiliated transaction—under specified conditions. At the time, commenters (including ICI) opposed the adoption of Rule 17a-9 because of concerns that the mere existence of such a rule would cause investors to expect a fund's adviser to buy out troubled securities from the fund, thus guaranteeing that the fund will maintain a stable NAV.

Oh, no, responded the SEC—"existing rules applicable to money funds already address this concern by requiring money fund prospectuses and sales literature to disclose prominently that there is no assurance or guarantee that a fund will be able to maintain a stable net asset value of $1.00 per share."

That was in 1996—a long time ago. But the SEC made the same arguments in 2010, two years after the Reserve Primary Fund broke the dollar and a year after Chairman Schapiro took office. Then, it amended Rule 17a-9, making it even easier for a sponsor to offer support by buying securities out of a money market fund portfolio. At that time, the SEC stated the amendments would not "materially change shareholder's perceptions about money market funds or the likelihood of sponsor support during times of market turmoil." Rather, the SEC noted that affiliated sponsor support "transactions appear to be fair and reasonable and in the best interests of fund shareholders."

Now, the SEC wants to use alleged investor confusion about sponsor support as evidence for the notion that money market funds pose systemic risk. But the agency's earlier analysis—that investors understand the clearly disclosed risks of money market fund investing—fits the facts better.

(As for that "recurrent sponsor support"—we've already discussed the misleading and deceptive nature of the SEC's tally of so-called sponsor support. That's perhaps the biggest myth of the batch.)

Misstatement: The growth of money market funds from 1990 to just before the 2008 crisis was "fueled largely by institutional investors, who were attracted to money market funds as apparently riskless investments paying yields above riskless rates."

Once again, the SEC hasn't offered any evidence to support its Chairman's conjectures about investors' behavior and beliefs. Institutional investors did indeed account for much of the growth in money market fund assets over this period—but let's look at the real reasons:

- Before the early 1990s, a much larger number of institutional investors, such as corporate cash managers, ran their own portfolios of money market securities. Over time, however, they found that money market funds were often a more efficient and less costly cash management vehicle, providing better diversification and credit and market analysis than cash managers could achieve on their own.
- For the same reasons, bank trust departments also increased their reliance on money market funds, fuelling institutional asset growth.
- Thanks to the Federal Reserve Board's Regulation Q, banks could not pay interest on business checking accounts until 2011. Cash managers who wanted to earn a market rate of interest increasingly turned to money market funds—which, by design, must pay a market rate of interest. Reg Q's impediment to paying interest on business checking accounts was removed temporarily in the Dodd-Frank Wall Street Reform and Consumer Protection Act after the financial crisis.

One last note on Chairman Schapiro's use of the phrase "yields above riskless rates" to describe a market rate of interest: market rates are higher than the "riskless rate" (usually defined as the rate on Treasury securities) because most securities are not risk-free. Neither are money market funds—a fact that's well understood by their investors.

This is the third ICI Viewpoints *posting on myths and misstatements about money market funds. The previous entries:*

- Correcting the Record: The "Susceptible to Runs" Myth
- Correcting the Record: Uncovering Regulators' False Narrative of 2008

Mike McNamee is Senior Director, Public Communications, at ICI. This post reflects analysis by Jane G. Heinrichs, Senior Associate Counsel, and Sean S. Collins, Senior Director, Industry and Financial Analysis.

INVESTMENT COMPANY INSTITUTE

Correcting the Record: Investor Protections in the SEC's 2010 Money Market Fund Reforms

By Mike McNamee

August 15, 2012

We've said it before, and we'll say it again: One of the most puzzling aspects of regulators' campaign for changes to money market funds is their ability to ignore the dramatic improvements in these funds resulting from the regulatory reforms that the Securities and Exchange Commission (SEC) enacted in 2010. Six months before Congress passed the Dodd Frank Act, the SEC became the first agency to address any of the financial products hit by the crisis, passing a package of sweeping changes to tighten regulation and make money market funds more resilient. For more than a year, those reforms have been tested by the ongoing European debt crisis, the standoff over the U.S. debt ceiling, and the historic downgrade of the U.S. credit rating—and money market funds have emerged strong.

To her credit, SEC Chairman Mary Schapiro acknowledges that "the 2010 reforms were extremely positive." But at the same time, her public statements—including her latest testimony before the Senate Banking Committee—frequently downplay and undercut those very reforms. Take today's example:

Misstatement: "I don't think [the 2010 SEC amendments] address the unfair results that can occur when a sophisticated institutional investor gets out quickly and losses are concentrated with retail investors, or retail investors are left in a frozen fund and can't access their liquidity."

Actually, the SEC's 2010 amendments address exactly this situation.

First, the healthy liquidity that the amendments require money market funds to hold sharply reduces the odds that a fund will become "frozen." As we've noted, liquid assets held by prime money market funds today are twice as great as the outflow from such funds in the week that Lehman Brothers failed in September 2008.

Second, these reforms, for the first time, give money market fund boards of directors the power to assure a fair and orderly liquidation of a troubled money market fund, should that be necessary.

In September 2008, the Reserve Primary Fund's board did not have the ability to promptly suspend redemptions—leading to a chaotic response when the fund broke the dollar. Now, the SEC has given money market fund boards a powerful new tool that will, in the SEC's own words, allow for the "orderly liquidation of fund assets" for a troubled fund and "reduce the vulnerability of investors to the harmful effects of a run on the fund, and minimize the potential for disruption to the securities markets."

To use this power, a board must decide to liquidate the fund. Once it does, shareholders are protected, because the board can suspend redemptions to ensure that "sophisticated" investors can't exit first and inflict losses on those remaining behind. The new rule recognizes that a money market fund's share price can decline in value, and provides for an orderly liquidation of the fund's securities in a manner that best serves the fund's shareholders. It would effectively negate any "first mover" advantages and avoid a fire-sale liquidation of the portfolio.

This new rule has yet to be tested—but Chairman Schapiro is already saying that it's not effective. That's odd, because she was head of the SEC when this rule was adopted. Once again, there's no analysis to explain her puzzling reversal.

The SEC has a long history of upholding the importance of mutual fund directors in ensuring fairness and protection for fund investors. The role of directors as "watchdogs for investors" was recognized by the U.S. Supreme Court as recently as its 2010 ruling in *Jones v. Harris Associates L.P*. But the SEC has gone strangely silent on the importance of money market fund directors since some of the Commission started campaigning for structural changes that will damage the value of money market funds for investors and the economy. In fact, Chairman Schapiro's testimony fails to mention even once the important role of boards in overseeing money market funds.

This is the fourth ICI Viewpoints *posting on myths and misstatements about money market funds. The previous entries:*

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- Correcting the Record: Regulators' False Narrative of 2008
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Mike McNamee is Senior Director, Public Communications, at ICI. This post reflects analysis by Jane G. Heinrichs, Senior Associate Counsel, and Sean S. Collins, Senior Director, Industry and Financial Analysis.

Correcting the Record: The Power of the SEC's 2010 Money Market Fund Reforms

By Mike McNamee

August 16, 2012

We've spent several days pointing out the myths and misstatements that regulators have put forward in their campaign to impose structural changes on money market funds. One recurring theme is the Securities and Exchange Commission's puzzling unwillingness to acknowledge the effects of its own reforms to these funds in 2010. The SEC was the first agency to adopt permanent new rules to address problems uncovered in the financial crisis. Its sweeping changes have made money market funds more resilient—as the standoff over the U.S. debt ceiling, the historic downgrade of the U.S. credit rating, and the ongoing European debt crisis have demonstrated.

Yet in her latest testimony before the Senate Banking Committee, SEC Chairman Mary Schapiro went out of her way to minimize the impact of the new rules on systemic risk. Her misstatements deserve a full response.

Misstatement: "The [2010] amendments did not (1) change the incentives of shareholders to redeem if they fear losses; (2) fundamentally change the dynamics of a run, which, once started, will quickly burn through fund liquidity; (3) prevent early redeeming, often institutional investors from shifting losses to remaining, often retail investors; or (4) enable money market funds to withstand a 'credit event' or the loss in value of a security held by a money market fund."

Let's take those one at a time.

1. Investors *always* have some incentive to redeem out of or sell *any* financial product—be it a bank deposit, a stock, a bond, or any other instrument—if they fear losses. That's human nature, and regulators might as well try to turn back the tides as hope to change that. Money market funds, like *all* financial assets, have risks. But the risk of investing in a money market fund is highly limited, by virtue of the regulations that the SEC has enacted over the last 30 years in Rule 2a-7—and significantly strengthened in the 2010 amendments.

2. The 2010 amendments *did* fundamentally change the dynamics of a period of heavy redemptions in at least two respects.

First, the 2010 amendments, for the first time ever, required money market funds to maintain specific levels of liquidity. Since 2010, taxable money market funds are required to hold at least 10 percent of their portfolios in assets that can be turned into cash that day, and 30 percent in assets that are liquid within a week. In practice, prime money market funds have exceeded those minimums by a significant margin, and now hold twice as much in liquid assets as the heaviest redemptions they faced in the worst week of the financial crisis in September 2008. Those liquidity requirements were tested by significant redemptions during the U.S. debt-ceiling and European debt crises in 2011—and funds met redemptions without problems. That makes it hard to believe Chairman Schapiro's assertion that redemptions "will quickly burn through fund liquidity."

What are these liquid assets? They're overnight loans and Treasury and other government securities—exactly the paper that anxious investors want to buy in a crisis. Remember, for every dollar that flowed out of prime money market funds in September 2008, 61 cents went back into Treasury and government money market funds. In a future crisis, government funds could simply buy many of the liquid assets of their prime counterparts to match investors' shifting demands.

Second, if a money market fund can't meet redemptions without breaking the dollar, the 2010 amendments allow the fund's board to liquidate the fund in an orderly manner—without a fire sale of portfolio securities or a first-mover advantage for early redeemers. Check out our earlier *ICI Viewpoints* entry for more on this important investor protection.

3. At the risk of repeating ourselves, Chairman Schapiro is again ignoring the powerful tool that the SEC gave money market fund boards in 2010 to protect slow-moving investors from suffering losses at the hands of first-movers. Equally important, the additional changes under discussion—forcing money market funds to float their value, or coupling capital requirements with holdbacks on investors' redemptions—won't stop sophisticated institutions from bolting from a troubled fund, particularly in the midst of a global financial crisis like 2007–2008.

The best way to prevent a recurrence of September 2008 is to prevent a recurrence of the crisis that was raging out of control for the 12 months prior. Regulators need to monitor any buildup of unsustainable risks in the banking sector and head off a collapse of confidence that will cause investors in *all* financial products to run.

4. Washington cannot outlaw credit losses on investments, whether commercial paper owned by money market funds or mortgages owned by banks. Risks have to be managed—and the 2010 reforms made money market funds far more capable of avoiding surprise credit events by raising the bar for credit quality of the securities they invest in and shortening the average maturity and life of the fund's portfolio.

The 2010 amendments also made money market fund portfolios far more transparent. New disclosure standards require a fund to report details every month on *every* security it holds, every piece of collateral backing repurchase agreements, and a wide range of other matters on the new Form N-MFP. Institutional investors have found this data invaluable in monitoring holdings of their funds and encouraging those funds to reduce credit risks. In fact, we hear that the SEC itself is monitoring Form N-MFP reports and contacting funds that could be taking credit risks that the regulators find worrisome.

For almost eight decades, the SEC has maintained that disclosure is a powerful tool in managing risks. It would be odd if regulators' self-imposed imperative to force structural changes on money market funds overwhelmed that principle.

Misstatement: The 2010 amendments to Rule 2a-7 "were not designed to address the structural features of money market funds that make them susceptible to runs."

Funny—Chairman Schapiro's statement in her testimony contradicts what her staff said in 2009, when the Commission proposed those amendments.

In the July 8, 2009, proposing release for the 2010 amendments, the SEC declared:

"Our proposals…are designed *to increase the resilience of money market funds to market disruptions* such as those that occurred last fall [i.e., September 2008]. The proposed rules would *reduce the vulnerability of money market funds to breaking the buck* by, among other things, improving money market funds' ability to satisfy significant demands for redemptions. If a particular fund does break the buck and determines to liquidate, the proposed rules would facilitate the orderly liquidation of the fund in order to protect the interests of all fund shareholders. *These changes together should make money market funds (collectively) less susceptible to a run by diminishing the chance that a money market fund will break a dollar* and, if one does, provide a means for the fund to orderly liquidate its assets. Finally, our proposals would improve our ability to oversee money market funds by requiring funds to submit to us current portfolio information." (emphasis added)

And that was *before* the triple crises of 2011 demonstrated that the 2010 amendments had met the SEC's goals by making money market funds stronger.

Misstatement: Money market funds continue to have "considerable exposure to European banks, with, as of May 31, 2012, approximately 30 percent of prime fund assets invested in debt issued by banks based in Europe generally and approximately 14 percent of prime fund assets invested in debt issued by banks located in the Eurozone."

Thanks to the new disclosures mandated by the 2010 amendments, regulators, investors, and analysts have had a ringside seat, with almost real-time monitoring, as money market fund managers have addressed the changing risk profile of European banks throughout the eurozone sovereign debt crisis. What those spectators have seen is that prime money market fund managers have had no direct exposure to banks in Greece, Ireland, and Portugal for many months. They've also seen fund managers reduce their exposure to eurozone-domiciled issuers by more than half in the past year, from 28.8 percent in June 2011 to 12.2 percent in June 2012.

Look a little deeper, and you'll see that roughly one-half of these funds' remaining exposure to eurozone banks is invested with banks that serve as "primary dealers"—counterparties to the Federal Reserve Bank of New York in its Treasury market dealings. And about half of that paper consists of repurchase agreements—overnight or short-term loans that are typically over-collateralized by more than 100 percent by U.S. Treasury or agency securities. In short, while regulators and critics point to all "European" investments as evidence that money market fund managers are taking undue risks, the institutions and securities that these funds invest in are actually deeply embedded in the U.S. financial system.

Close observers (or readers of *ICI Viewpoints*) also would have seen that money market funds have shortened the maturity of their remaining eurozone holdings substantially. In June 2011, only 37 percent of money market funds' exposure to French issuers was due to mature in 30 days or less. A year later, 80 percent of that paper was 30-day or shorter.

Just two years after the SEC's risk-limiting amendments to Rule 2a-7 (higher credit quality, lower maturities, and required liquidity levels) took full effect, money market funds have faced major challenges to the stability of the short-term credit markets. Those challenges brought exactly the type of heavy redemption pressures that those amendments were designed to address.

It's a rare event for regulators to see their handiwork tested so quickly. It's a shame that they feel they need to sell those new rules—and money market funds—short in their drive for further, damaging, structural changes.

This is the fifth and last in a series of ICI Viewpoints *postings on myths and misstatements about money market funds. The previous entries:*

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- Correcting the Record: What Money Market Fund Investors Know
- Correcting the Record: Investor Protections in the SEC's 2010 Money Market Fund Reforms

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