Talking Points Against Floating NAV for Money Market Funds

Stable NAV Provides More Benefits to Investors than Floating NAV

- The benefits to investors of a stable $1.00 NAV are many. The $1.00 NAV provides convenience and simplicity in terms of tax, accounting, and recordkeeping. In addition, many institutional investors are permitted to use money market funds only if such funds maintain a stable NAV.
- Floating the NAV would undermine money market funds' convenience and simplicity and would raise new accounting, legal, and tax hurdles whose resolution is uncertain, threatening the continued use of money market funds.
- ***Tax convenience***: A stable $1.00 NAV relieves investors of having to consider the timing of purchases and sales of shares of money market funds, as they must with floating NAV funds, to comply with the so-called "wash sale rule." If money market funds had a floating NAV, all share sales become tax-reportable events, potentially greatly magnifying investors' tax and recordkeeping burdens.
- ***Accounting simplicity***: Stable $1.00 NAV, money market funds qualify as "cash equivalents" under accounting standards. Because the NAV is fixed at $1.00 per share, there is no need for investors to recognize gains or losses for financial accounting purposes. With a floating NAV, different accounting standards would apply. Companies would likely have to reclassify their holdings of money market funds as "available-for-sale." As a result, companies would face the additional burden of having to mark to market the value of their money market fund shares and track the costs of their shares and determine how to match purchases and redemptions for purposes of calculating gains and losses for accounting and tax purposes.
- ***Operational convenience***: For corporations and bank sweep accounts, a stable share price for money market funds simplifies operations because the $1.00 NAV is known in advance. Corporations sometimes have internal guidelines or cash management policies that are easier to adhere to with a stable $1.00 NAV. In addition, broker-dealers typically offer retail investors a range of features including ATM access, check writing, and ACH and fedwire transfers. These features are generally provided only for accounts with a stable NAV. For example, money market funds typically offer retail investors same-day settlement on shares redeemed via "wire transfers", whereas bond funds typically offer *next day* settlement for wire transfers.
- ***Legal and other constraints***: Institutional investors often face legal or other constraints that allow them to invest their cash balances in stable NAV money market funds. Most corporations have board-approved policies permitting them to invest operating cash balances only in cash pools that do not fluctuate in value. Indentures and other trust documents often authorize investments in money market funds because of their stable NAV. Many state laws and regulations also authorize municipalities, insurance companies and other state regulated entities to invest in stable NAV funds. Thus, under a floating NAV, many corporations, trusts, and state and local governments would no longer be willing or able to use money market funds to help manage their cash.

Floating NAV Could Lead to Detrimental Consequences for Markets

- ***Increase systemic risk:*** Asset managers would find other means to offer a stable NAV cash pool, leading to rapid and substantial disintermediation from money market funds, particularly by institutional investors, into pools outside the protections of the Investment Company Act. Inflows into these alternative investments would create large pools of assets either domestically or offshore that would fall outside the careful regulatory framework in place for money market funds, and potentially increase the systemic risk to the financial system.

- ***Reduce supply of short-term credit:*** In the absence of alternative stable NAV investment pools, cash held in money market funds would presumably flow to traditional banks. This would result in a significant reduction in the supply of short-term credit to corporate America unless banks raised significant amounts of capital. Even with the capital to support this expansion, the market would be less efficient and the cost of short-term credit would rise.
- ***Eliminate supply of credit to municipalities:*** Municipalities would lose an important source of financing in the short-term markets because banks cannot pass through tax-exempt income and simply could not replace tax-exempt money market funds.

Floating NAV Unlikely to Reduce Systemic Risk

- Floating the NAV of a money market fund will not lessen the incentive for investors to redeem shares rapidly in periods of market turmoil.
- The experience of some floating NAV money market-like funds in the recent financial crisis exemplifies this point. Ultra-short bond funds in the U.S., which are similar to money market funds in that they generally invest in fixed-income securities with short maturities, saw substantial outflows by investors. By the end of 2008, assets in these funds were more than 60 percent below their peak in mid-2007. Abroad, French floating NAV dynamic money funds (or trésorerie dynamique funds) began to suffer significant investor outflows in the summer of 2007 when problems in the credit markets from exposure to U.S. subprime mortgages surfaced. Assets in these funds contracted by about 40 percent over a three-month time span from July 2007 to September 2007 and by year-end 2008 assets were down an additional 20 percentage points.
- Some commentators point to long-term mutual funds, particularly equity funds, which at times have suffered significant losses but typically experienced only modest outflows. It is misplaced to attribute this seemingly more stable behavior solely to the presence of floating NAVs. Investors in equity funds rationally expect the market value of the fund to fluctuate, perhaps, widely at times, and as such likely are more apt to hold their fund shares in periods of market turmoil than investors in fixed-income funds.
- Shareholders in fixed-income funds tend to be more risk adverse and more likely to redeem shares quickly when fixed-income markets show any signs of distress. For example, in the fourth quarter of 2008, bond funds authorized in Luxembourg experienced outflows of €48 billion, or 12 percent of their assets, even though the funds had valuation declines of only about 3 percent.
- Investors' demands for redemptions can outstrip the ability of fixed income funds—even those with floating NAVs—to meet such redemptions because assets cannot be quickly sold in an illiquid market.