

MONEY MARKET FUNDS IN 2013

A Bad Idea: Forcing Money Market Funds to Float Their NAVs

The stable net asset value—typically \$1.00 per share—is a fundamental feature of money market funds.

Investors purchase and redeem millions of dollars in money market fund shares every day. Without the ability to operate at a stable net asset value (NAV), money market funds could not provide individuals and institutions the cash management services that they seek.

- See [*Money Market Fund Regulations: The Voice of the Treasurer*](#).

FSOC's idea of setting a \$100 price for money market funds is arbitrary and flawed.

The Financial Stability Oversight Council (FSOC) has proposed that money market funds reprice their shares from \$1.00 (the price that money market funds customarily seek to maintain) to \$100.00 per share. This idea is flawed for several reasons, including the following:

- No current laws or regulations require any investment company registered under the Investment Company Act of 1940 to offer its shares at any particular price.
- FSOC's proposed recommendation seems to require that money market funds comply with a pricing standard at least 10 times more onerous than that suggested by the U.S. Securities and Exchange Commission (SEC) for other mutual funds.
- A \$100 NAV money market fund could potentially float more than an ultrashort bond fund, thus destroying the attractiveness of money market funds to millions of shareholders who rely on them now.

Floating the NAV of money market funds is unlikely to change investor behavior.

- Experience shows that mutual funds that float their NAV are not immune to redemption pressure.
- Floating-value ultrashort bond funds in the United States, which generally invest in fixed-income securities with short maturities, saw substantial outflows during the financial crisis. By the end of 2008, assets in these funds were more than 60 percent below their mid-2007 peak.

Forcing money market funds to float their NAVs could increase risks to the financial system.

- Institutions that want or require stable value funds for their cash balances would turn to private pools, operated in the United States and overseas, that promise to maintain a fixed price.
- These alternatives are not registered with the SEC. Nor are they subject to regulation under the Investment Company Act, including the risk-limiting provisions of Rule 2a-7 governing credit quality, liquidity, diversification, maturity, and disclosure.
- Inflows into these alternative investments would create large pools of assets, either domestically or offshore, that would fall outside the robust regulatory framework in place for money market funds.
- Investors in these pools would be more likely—not less—to withdraw their assets in a future crisis.

Retail and institutional investors vote with their dollars for stable NAV funds.

- Currently, yields on money market funds are on average 125 basis points below ultrashort bond funds, and 200 to 350 basis points below longer-term bond funds. Yet, assets in money market funds as of January 2013 are roughly \$2.7 trillion—more than 7 times the amount invested in short-term domestic bond funds—which is a sign of investors' commitment to this stable cash management vehicle.

The stable NAV provides significant benefits to investors.

For investors, the \$1.00 NAV provides convenience and simplicity in terms of taxes, recordkeeping, accounting, and operations.

- **Tax convenience:** If money market funds had a floating NAV, all share sales would become tax-reportable events, vastly multiplying investors' tax and recordkeeping burdens. 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.
- **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, companies and other organizations would face significant additional burdens of:
 - marking to market the value of their money market fund shares;
 - tracking the costs of their shares in order to calculate gains and losses when shares are redeemed for accounting and tax purposes.
- **Operational convenience:** For corporations and intermediary sweep accounts, a stable share price for money market funds simplifies operations because the \$1.00 NAV is constant. Corporations sometimes have internal guidelines or cash management policies that require investments in a stable \$1.00 NAV product. Without a stable NAV, funds and intermediaries would be unable to provide institutional and retail investors with same-day settlement on shares redeemed throughout the day.

Floating the NAV would undermine money market funds' convenience and simplicity and confront investors with new accounting, tax, and legal complications.

If money market funds are forced to abandon the stable NAV, many investors will be forced to abandon money market funds.

Many institutions face legal constraints or investment policies that allow them to invest their cash balances only in cash pools that seek to maintain a stable NAV. Indentures and other trust documents often include similar restrictions. Many state laws and regulations also authorize municipalities, insurance companies, and other state-regulated entities to invest available cash in stable NAV funds—but not in floating NAV funds. Thus, if money market funds were required to float their NAV, many corporations, trusts, and state and local governments would no longer be willing or able to use these funds to manage their cash.

Forcing money market funds to float their NAVs could harm the economy.

If cash held in money market funds flows to traditional banks, corporate America would face a significant reduction in the supply of short-term credit unless banks raised substantial new capital. Even if banks had ready access to the capital to support this expansion, the lending market would be less efficient and the cost of short-term credit would rise.

Forcing money market funds to float their NAVs could deprive state and local governments of much-needed capital.

Individuals are the primary investors in tax-exempt funds, and these investors would have few stable-value alternatives to invest their cash. If they shifted their holdings to banks, banks could not replace money market funds as a supply of credit to state and local governments. Banks cannot pass through tax-exempt income to depositors and thus simply could not replace tax-exempt money market funds. This would cost municipalities an important source of financing in the short-term markets.

Support for stable NAV funds—and opposition to forcing funds to float their NAVs—is wide and deep.

The idea of forcing floating NAVs on money market funds has run into consistent and widespread opposition. For example, of the individuals and organizations commenting on the President's Working Group Report on Money Market Fund Reform, those that favored floating values numbered less than 20. By contrast, more than 100 groups, companies, and individuals opposed floating NAVs. Those against floating NAVs were organizations as disparate as the Association for Financial Professionals, the National Association of State Treasurers, the National League of Cities, and the U.S. Chamber of Commerce.

For more information on money market funds, their role in the economy, ICI's efforts to make these funds more resilient in the face of adverse market conditions, and the significant risk of undermining money market funds' value to investors and the economy, please see www.ici.org/mmfs or www.PreserveMoneyMarketFunds.org.