

The Money Market Fund: Why It Matters

“The Money Market Mutual Fund: Why It Matters”

Money Market Funds: Weathering the Financial Crisis, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce

Morning Keynote by

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Good morning and thank you.

I want to thank the Chamber for hosting this conference on this very important topic.

I have a favorite quote from Henry Ford that says, “Anyone who stops learning is old, whether at 20 or 80. Anyone who keeps learning stays young. The greatest thing in life is to keep your mind young.”

Well, the past 18 months have been one of the greatest learning experiences that we could have asked for with respect to the markets generally, the money markets more narrowly, and money market funds specifically. It didn’t matter whether we were long-time veterans of the business or new the market, there was much to learn. Whether one is an investor in or sponsor of money market funds, a corporate or governmental issuer of securities, a regulator, an academic, or serving in a myriad of other roles, the opportunities to learn, debate, question, and react have been too numerous to count.

That said, with many months of hindsight, two things are very clear. First, the American economy needs deep and robust money markets to function effectively. And, second, the money market fund

industry is vital to ensuring that those markets work well.

So, this morning, to kick off what should be a very interesting discussion about money market funds, I want to share with you with my views on three topics related to this vital investment product: Why they matter, whom they matter to, and why they will continue to be such a critical part of our financial system.

But first, a bit of background. As you may know, last year I was asked to head the ICI Money Market Working Group. Simply put, it was one of the most interesting assignments of my career—for many reasons.

We had industry-wide participation and collaboration. The amount of attention and experience put forth by the industry to work on the near-term (and longer-run) challenges in the money markets was incredible. In the midst of the single worst credit and liquidity crunch in the history of modern capital markets, firms came together and studied the issues. We had company leaders, portfolio managers, legal experts, and research analysts working together. And we talked to investors, issuers, regulators, and other affected parties. We had great collaboration with, and leadership by, our terrific ICI team.

In the end, we produced a comprehensive 216-page report on money market mutual funds, complete with the history of the funds, an analysis of competing products and ideas, and an examination of the events of last September when The Reserve Primary Fund broke the buck.

And, in the report, we made recommendations for improving money market funds. These recommendations were informed by the market events of the past 18 months, but, more importantly, they are based on three-and-a-half decades of experience serving money market fund investors.

Importantly, too, this is not a first-time exercise for the industry. We have a long-standing tradition of attacking challenges head-on in an effort to help our regulators and help ourselves ensure both that our clients' interests are served as well as possible and that our industry remains the best place for those clients' investment assets. We've done it with respect to money market funds in the past, and with respect to personal trading activities, governance structures and principles for funds, and many other topics. After all, who knows better what's best for our clients than we do?

The single greatest intermediation vehicle

The exercise that we began last fall as the Money Market Working Group turned out to be a wonderful learning experience. It involved meticulous research, detailed analysis, and lively discussion and debate. Make no mistake: We did not start with a conclusion. I believe that all the participants learned from the experience. I know that I did. As Henry Ford would say, the experience is keeping us all young.

While the main “product” of our efforts was a formal list of recommendations to improve money market funds, to me the sum of our great collective effort was the reaffirmation of a single, long-standing concept which was, I admit, a going-in bias of mine (and, I suspect, of many others in the industry.)

The belief is this: The money market mutual fund is the single greatest intermediation vehicle ever invented. Period.

It’s a well-orchestrated, highly regulated, and mutually beneficial handshake between two parties:

- For investors, the money market fund has provided what you might call the “hat trick” of safety, liquidity, and yield—for more than 35 years.
- For issuers, it has meant simple, low-cost financing, whether you’re J.P. Morgan or the local school district.

Think about that. It’s almost alchemical in nature. Better returns for investors than they can receive from other types of liquid, safe investments like bank accounts. Lower costs of financing than issuers can find from other sources. A true win/win situation. Generally, that’s not supposed to happen in markets like these.

So, how does it happen? How can investors and issuers (and the broader economy) all benefit? It comes down to the structure of the funds and the nature of their investments: They are short-term, transparent, very high-quality, and very low-cost.

The low-cost aspect is a very valuable part of the equation. In truth, it’s the key source of the alchemy, when you look at the cost of operating money market funds compared to the overhead associated with traditional financial institutions. Money market funds serve their investors and the issuer community at a cost measured in basis points rather than percentage points.

For investors: Safety, liquidity, and yield in true “mutual” funds

The objectives of money market investors are clear. We’ve known them for a long time, but they were confirmed in our research. Investors seek that hat trick of safety, liquidity, and yield. In that order of importance. Safety, liquidity, and yield. Yield is essentially a byproduct of the first two (safety and liquidity) powered by low costs.

One of the fascinating things about these client needs is that they are the same for all investors, from the largest institutions with billion-dollar accounts to my kids putting their summer earnings to work.

In the end, these investor priorities served as a guidepost for the Working Group and for our recommendations.

Another important (and perhaps underappreciated) benefit of regulated money market funds is their power as an aggregation vehicle for millions of investors.

Money market funds are, perhaps, the very best example of the “mutual” aspect of the mutual fund industry. If you think about it: As an individual, you can open a brokerage account, buy 50 different stocks and bonds, and construct a well-diversified portfolio. It might not be very cost-effective, but you can do it.

However, you cannot, as an individual, phone up General Electric and ask to purchase 7-day commercial paper. Or call your local municipality and buy variable-rate demand obligations. Without money market mutual funds, individuals would have no realistic access to the money markets.

The same thing is true for institutions. The liquidity and professional management offered by money market mutual funds is something that most companies cannot do on their own. They don’t have the skill set; they don’t have the scale. So this “mutual” aspect allows trillions of dollars to be accumulated and recycled into the economy, efficiently and effectively.

And it has worked. It has worked far better than unregulated cash management pools or “near” cash vehicles which, as we’ve seen, can run into problems. In the stressful environment of 2008 and 2009, highly regulated money market funds proved to be the best options for investors.

For issuers: Diversified sources of funding

On the other side of our alchemical equation is the issuer—and the role that money markets play as a diversified source of funding for the American economy. Any competent treasurer or CFO wants diversified sources of funding (some short-term, some long-term, some from consumers, some from institutions, etc.). This is a vital part of how America finances itself.

And, American corporations, governments, and financial institutions depend on well-oiled, efficient money markets. We all do, if we are to have a robust economy. It’s a simple fact.

Of course, we all got a wake-up call in October. We saw what happened when the money markets didn’t work and the Fed had to step in and create vehicles to allow those money markets to continue to function. It was a rebellion, of sorts, in the market. And it was the near-death of the economy. None of us—not investors; not fund sponsors; not issuers; not regulators—wants to go through that experience again.

What a stark reminder of the critical role that money market funds play in the day-to-day functioning of the broader economy.

Improving our neighborhood

In the 35 years that money market mutual funds have been in existence, trillions upon trillions of dollars have been invested in and taken out of these funds. When you look at stable sources of funding for American businesses and municipalities, these diversified funds (overseen by independent boards of directors and regulated by the SEC) have been an incredibly powerful force for issuers and investors.

Since the introduction of the money market fund, we've seen two failures. One was fairly insignificant; the other quite meaningful. What happened last September was terrible, and it should not have happened. But it triggered intense reflection and examination in our industry. It was therapeutic and highly informative. We approached our study by asking, "How do we ensure that the next 35 years are even better for investors and the economy because of money market funds' participation?"

As an industry, we view money market funds as critical to the success of our clients and to the success of our business. There's an expression we use in the mutual fund industry, and it applies with particular weight to the money market category: We all live in the same neighborhood. We don't need people not mowing their lawns. And worse, we don't need people playing with matches inside their house.

As I said earlier, we have a history of continually asking ourselves, "How can we improve the neighborhood?" That goes back as far as the establishment of the SEC's Rule 2a-7, and to changes recommended by the industry (and implemented by the SEC) to change maturity requirements and raise quality standards in the late 1980s and early 1990s. Today, we're looking at ways to make the product even better.

Every recommendation we made was driven by a singular objective: Assuring that this product works best for our investors.

I've been asked if I was surprised by any of the findings of the Money Market Working Group. My answer is both "no" and "yes."

No, I was not surprised by any individual finding. The prime levers in meeting our clients' goals are easily observed—quality, maturity, disclosure, oversight. Nor was I surprised that when we asked the industry to take a critical look at itself, we found that most funds were already running at a "best practices" level. No one was operating on the "edge." The history of money market fund management is one of prudence, so we weren't expecting any surprises. Again, I point to the first two elements of the investors' hat trick: safety and liquidity. We've long known that it's not worth sacrificing the first two elements for a few extra basis points of yield.

But yes, I was surprised at how quickly our industry rallied to the concept of enhancing the product even further—despite a stellar record of success for clients. There was no, "It's a 100 year flood; it won't occur again." There was no, "Let's not float any ideas that might hurt our competitiveness." There was no self-pity. There were open minds and enthusiasm, realizing there were steps we could take to further enhance the safety and liquidity of money market funds for investors. And I was greatly encouraged that this was recognized by everyone in the industry, and that the recommendations to

improve these funds were quickly and unanimously adopted.

The history of money market funds has been a great success story. But, the great American humorist, Will Rogers, put it best when he said, “Even if you’re on the right track, you’ll get run over if you just sit there.” As I said earlier, our industry has never been satisfied with “just sitting there” and taking what we’ve learned—again, over the long-run and in the short-term—to make money market funds and the money markets even more effective for the next 35 years than they’ve been in the past has to be our goal.

And the future of these funds can be even brighter as we seek to:

- Mandate liquidity in the funds
- Shorten maturity
- Raise quality standards
- Improve disclosure to investors and regulators
- Require clarity about the business model and client type
- And enhance (yes, enhance) the regulatory oversight of the product.

These recommendations are already widely embraced by industry participants and investors, and, if codified, could further strengthen the vital role that money market mutual funds play for investors and for our economy.

We recognize, of course, that there are other concepts that have been raised—floating the net asset value, requiring capital commitments on the part of sponsors, bank-like regulation, etc.—and almost assuredly they will be discussed and debated both here this morning and as regulatory reform takes shape. That’s a healthy thing.

But, in the end, we can all have only one goal for the money market fund. That is, to ensure that this bit of alchemy, this intermediation vehicle that serves investors, issuers, and the country better than any other, continues to do so in the future even more effectively than it has during the past 35 years. I have no doubt that it will.

Thank you for listening. I look forward hearing the rest of today’s discussion.