

Enough Already. Money Market Funds Aren't Shadow Banks

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By Paul Schott Stevens

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In July 2014, the U.S. Securities and Exchange Commission enacted sweeping new rules for [money market funds](#), setting an aggressive implementation deadline: October 14, 2016. Though the rules required significant operational changes, money market funds have met the new requirements on time.

As a result, today's money market funds are very different products than their [precrisis predecessors](#). The reforms, which are meant to prevent a repeat of the heavy redemptions from money funds brought on by the banking crisis of 2008, have added layers of transparency and redundant safeguards that more than adequately address any risks that may have existed. Moreover, the reforms have prompted a large shift in assets from [prime](#) to [government](#) money market funds. Yet with all of these new rules, some still clamor for further regulation, using disparaging terms like “shadow banking” to spark fear in the minds of regulators and investors alike.

Enough already. Money market funds are not shadow banks. They are fully transparent, regulated investment vehicles that have been a reliable cash management tool for millions of individuals and institutions for decades. Calls for additional layers of burdensome regulation over this industry are not only premature, but unwarranted.

Though sweeping in scope, the new rules are actually just the latest in a series of SEC regulations that have been designed to reduce risk in money market funds following the financial downturn of 2008.

The latest rules add to an earlier, comprehensive rulemaking in 2010, which set a number of new standards—including liquidity requirements and stress tests—to enhance the resiliency of money

market funds. These reforms were tested and proven in 2011, when Europe's sovereign debt crisis and the federal debt-ceiling crisis rattled markets, and showed their value again after the [Brexit vote](#) in the United Kingdom.

Now, the latest rulemaking has added even more protection against market shocks, in a number of ways.

First, the SEC's reforms require institutional money market funds (both prime and tax-exempt) to price and transact their shares using a floating net asset value, rather than a constant NAV of \$1.00, based on the market value of portfolio holdings at the time they calculate their NAVs. The new rules also require funds to calculate their NAVs to four decimal places (for instance, for funds with a \$1.00 NAV, to one-hundredth of a penny, or \$1.0000).

Though this change required fund sponsors and pricing vendors to spend significant time and money reprogramming and testing system algorithms that calculate NAVs, this highly technical work has succeeded—firms are prepared to meet the demand for unprecedented levels of precision on the valuation of floating NAV money market funds.

Many investors, meanwhile, will be able to continue to use floating NAV funds as [cash management](#) vehicles because fund sponsors have created systems to strike the funds' NAV multiple times a day, ensuring that investors have intraday access to their balances. Fund prospectuses and other investor education materials will inform investors about how the floating NAV requirement is implemented for each fund.

Secondly, the SEC reform permits money market funds' boards of directors to impose certain conditions on redemptions (so-called liquidity fees and gates) during extraordinary circumstances. This is also a significant change. At the Investment Company Institute, discussions with our members about the transition to the new rules revealed that the fees-and-gates requirement, which applies to all prime and tax-exempt funds, is a larger concern to investors than policymakers anticipated when writing the rules. In addition to making the operational changes required to implement this requirement, funds have subsequently spent a considerable amount of time communicating to shareholders about fees and gates, including explaining why the likelihood of fees and gates actually being imposed is so small.

Funds have worked overtime to prepare for the new regulatory landscape, with remarkable success. While the new rules went into force on Oct. 14, large shifts of assets have already been occurring in the money market fund sector—a process that funds and their advisers have smoothly managed.

Since November 2015, nearly \$1.1 trillion in assets have moved out of prime and tax-exempt money market funds, with a nearly equivalent inflow of cash into government money market funds. On its face, this is a staggering sum of money—but the industry foresaw this migration, and shortened the maturities of portfolio holdings to increase liquidity and meet investor demands.

Markets and products evolve. While today's money market funds are very different products than their precrisis predecessors, the \$2.6 trillion in assets they hold today prove investors are confident in the industry's ability to continue meeting their needs for years to come.

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