The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE
Washington, DC // Brussels // London // www.ici.org

ICI VIEWPOINTS

MARCH 29, 2012

What Happens If 'Floating' Funds Don't Float?

By Jane Heinrichs and Gregory Smith

Some recent coverage—including the *CFOJournal* blog of the *Wall Street Journal*—suggests that worries about the impact on investors of forcing money market funds to float their net asset value (NAV) may be overblown. The story goes like this: the mark-to-market prices of money market funds, and the experience of a few money market funds that already operate with a floating NAV, show that fluctuations in the "floating" value would be minuscule—rarely large enough to change the penny-rounded per-share price of the fund. So if floating funds don't float, what's the harm?

Well, there are two problems—cost and benefit. Floating funds that don't float will bring very high costs—but they won't provide any benefits. That's a bad deal all around.

Regulations that require money market funds to abandon their stable $1.00 NAV will impose very substantial costs on investors and funds whether the funds' actual per-share values ever move or not.

State laws and investment policies bar many governmental bodies, nonprofits, and businesses from investing cash in floating-value products, so those investors would have to retool their cash management and give up the convenience, stability, and liquidity of money market funds. Accounting standards setters aren't likely to grant cash-equivalent status to floating-value money market funds, which means institutions would have to track and reflect any fluctuations in shares' values on their books. Individuals and many institutional investors would have to regard every money market fund transaction as a potentially taxable event, and funds would have to build reporting systems to track gains and losses in the pennies.

In short, the fact that money market funds *could* float means that investors, funds, and intermediaries have to be prepared that they *will* float. Changing the nature of these funds from stable to floating would force funds and investors to adapt, build new accounting systems, and overhaul their cash management—whether the funds' value actually fluctuates or not. The result would be heavy costs.

And on the benefit side of the balance? Securities and Exchange Commission (SEC) Chairman Mary Schapiro has said, "these proposals are designed to…desensitize investors to the occasional drop in value." The SEC reasons that if investors see the value changing frequently, they won't redeem in turbulent markets. We don't agree with that line of argument; the SEC has offered no evidence to support it; and there's plenty of evidence that investors behave differently in crisis than in normal markets. In any case, if in practice a fund's value never changes, investors won't be "desensitized"—and none of the benefits that the SEC hopes to gain will materialize.

In fact, we would agree that floating funds aren't likely to float. Look at what happened to money market funds' mark-to-market values last summer, at the height of the eurozone crisis. Studying the prime funds with the greatest exposure to European financial institutions, we found that their floating value dropped by 0.9 basis points. On a $1.00 share, that's nine one-thousandths of a penny.

That kind of float is not going to move a share priced at $1.00; in fact, it would not move a $10 share. It might—in extreme conditions like the eurozone crisis—move the price of a $100 share. So, if the SEC really wants money market funds to float enough to register at all on investor psychology, our research suggests that they're going to have to reprice them to *$1,000* a share.

Huge costs for zero benefits—our economists tell us that's a cost-benefit ratio that rapidly approaches infinity. What we calculate is that floating funds are a bad deal for investors and the economy.

Jane Heinrichs is associate general counsel for ICI.

Gregory Smith was senior director of operations, compliance, and fund accounting for ICI.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.