

ICI Study: Capital Buffers Could Undermine Money Market Funds, Harm Shareholders

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SEC Concept Would Raise Costs, Could Drive Sponsors Out of Product, and Create New Systemic Risks

Washington, DC, May 16, 2012 - Requiring money market fund advisers to hold capital to support their money market funds would fundamentally change the nature of these funds, according to a new study by the Investment Company Institute released today. Depending on the size of the capital buffer and the assets covered, a capital buffer could result in advisers shifting to less regulated products or exiting the cash management business altogether. These changes would not benefit investors and could lead to greater systemic risk in the economy.

“This study confirms the problems with the capital buffer concept that we have noted for some time,” said ICI President and CEO Paul Schott Stevens. “Our analysis shows that this approach, like the other money market fund changes being weighed by the SEC, could undermine the money market fund as a product. Investors, as a whole, could well be deprived of a powerful tool for cash management, and retail investors would have lower rates of return if forced into bank deposit accounts. More broadly, financing for key sectors of the economy could be disrupted and systemic risk potentially increased, as cash balances of institutional investors migrate to less-regulated, more-opaque financial instruments.”

Concept Could Lead Advisers to Shift to Less Regulated Products or Exit the Business

The study, “[The Implications of Capital Buffer Proposals for Money Market Funds](#),” analyzed a range of approaches, including requiring fund advisers to commit capital, requiring funds to raise capital in the market, or requiring funds build a capital buffer inside funds from retained income.

“Requiring advisers to put up capital places them in a first-loss position for their funds—a risk that they are not being paid to assume,” said ICI Chief Economist Brian Reid. “It’s hard to imagine many fund sponsors deciding to undertake this new cost that they could not cover. Instead, many would likely stop offering money market funds and turn to managing similar, but less regulated products—an outcome desired by neither regulators nor investors.”

Requiring Fund Advisers to Commit Capital Would Alter Money Market Funds’ Nature

Imposing capital requirements on a fund adviser would shift the investment risks from fund shareholders to advisers, requiring advisers to absorb possible losses in the funds that they manage. While the potential for losses is remote, the cost of providing capital could be significant. As a practical matter, the study concludes, advisers have no ability to pass along cost increases to investors in the current very low interest rate environment. But even with more normal interest rates and fund revenues, the fee increases needed to provide a market rate of return on adviser-provided capital could be prohibitive, the study finds.

The analysis demonstrates that capital buffer requirements, especially those that require fund advisers to pledge capital, could lead fund advisers to make business decisions that dramatically alter the money market fund business. The changes could negatively impact the money markets, business cash management practices, and regulators’ ability to monitor risks in the financial markets.

ICI has filed the study with the Securities and Exchange Commission (SEC). For more information, visit ICI’s [money market funds resource page](#).
