INVESTMENT COMPANY INSTITUTE

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MONEY MARKET FUNDS IN 2012
History of Money Market Funds

Money market funds are one of the most significant financial innovations of the past century.

- Money market funds were created in the early 1970s and have become a steady, predictable mainstay of finance.
- Money market instruments generally offered yields significantly higher than the rates banks were legally allowed to pay under Federal Reserve Regulation Q, which placed a ceiling on bank deposit rates.
- In the 1970s and 1980s, for the first time, money market funds gave retail investors access to market rates of return, which was much higher than the rates set by banks.
- Money market funds are investment products.
- Money market funds are not guaranteed or insured by any agency of the government or the fund sponsor. Investors can lose money in a money market fund, although they rarely do.

Money market funds are also a regulatory success story. They are subject to a comprehensive regulatory scheme under the federal securities laws that have worked extremely well for decades.

- Money market fund operations are subject to all four of the major federal securities laws administered by the Securities and Exchange Commission (SEC), including the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, and the Investment Company Act of 1940.
- Since 1983, money market funds have been governed very effectively by the SEC, regulated by Rule 2a-7 under the Investment Company Act of 1940, which strictly limits the risks these funds can take. The adoption of the rule created the framework for the current money market fund industry.
- Key characteristics of money market funds include a stable $1 net asset value (NAV), liquidity, market-based rates of return, a goal of returning principal, high-quality assets, investment in a mutual fund, diversification, professional asset management, and economies of scale.
- In 2010, the SEC adopted amendments to Rule 2a-7, which strengthened money market fund standards for liquidity, credit quality, maturity, and transparency.
- The SEC also granted money market fund boards significant new powers to protect the interests of fund investors by providing a means for the orderly liquidation of a troubled fund.

In their 40-year history, only two money market funds have not returned the full $1.00 per share.

- In 1994, the Denver-based Community Banker's U.S. Government Money Market Fund reported a NAV below $1.00 and ultimately investors recovered approximately 96 cents on the dollar.
  - The fund had invested a large percentage of its assets into adjustable rate securities. As interest rates increased, these floating rate securities lost value. It was an institutional fund—no retail investors were affected. The fund ultimately returned 96 cents on the dollar to shareholders.
  - The event did not lead to widespread outflows from money market funds, in large part because there was no vast U.S. financial crisis in 1994.
- In September 2008, the Reserve Primary Fund, a $60 billion money market fund, held large quantities of Lehman Brothers debt.
  - When Lehman failed on September 15, the fund ran into financial trouble and could not return $1.00 per share. Ultimately, Reserve investors were paid 99 cents on the dollar.
  - Lehman's failure, coming after a string of bankruptcies, takeovers, and rescues of major financial institutions in the broader 2008 financial crisis, triggered a freeze in the money markets. Banks, seeking to preserve their liquidity, refused to lend to one another and investors lost confidence in financial institutions' securities. The result was a widespread lack of liquidity.
  - The illiquidity caused money market investors, including money market funds, to have problems selling assets.
  - Some money market fund sponsors stepped in to provide capital support to their funds so they could maintain the $1.00 per share value.
  - This sponsor support is not required by law and is a testament to the industry's commitment to providing money market funds to investors.

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*.