

# Report of the Money Market Working Group

## Summary of Findings and Recommendations

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Brian Reid

Do Money Market Funds Have a Future in the  
New Financial System?

May 5, 2009

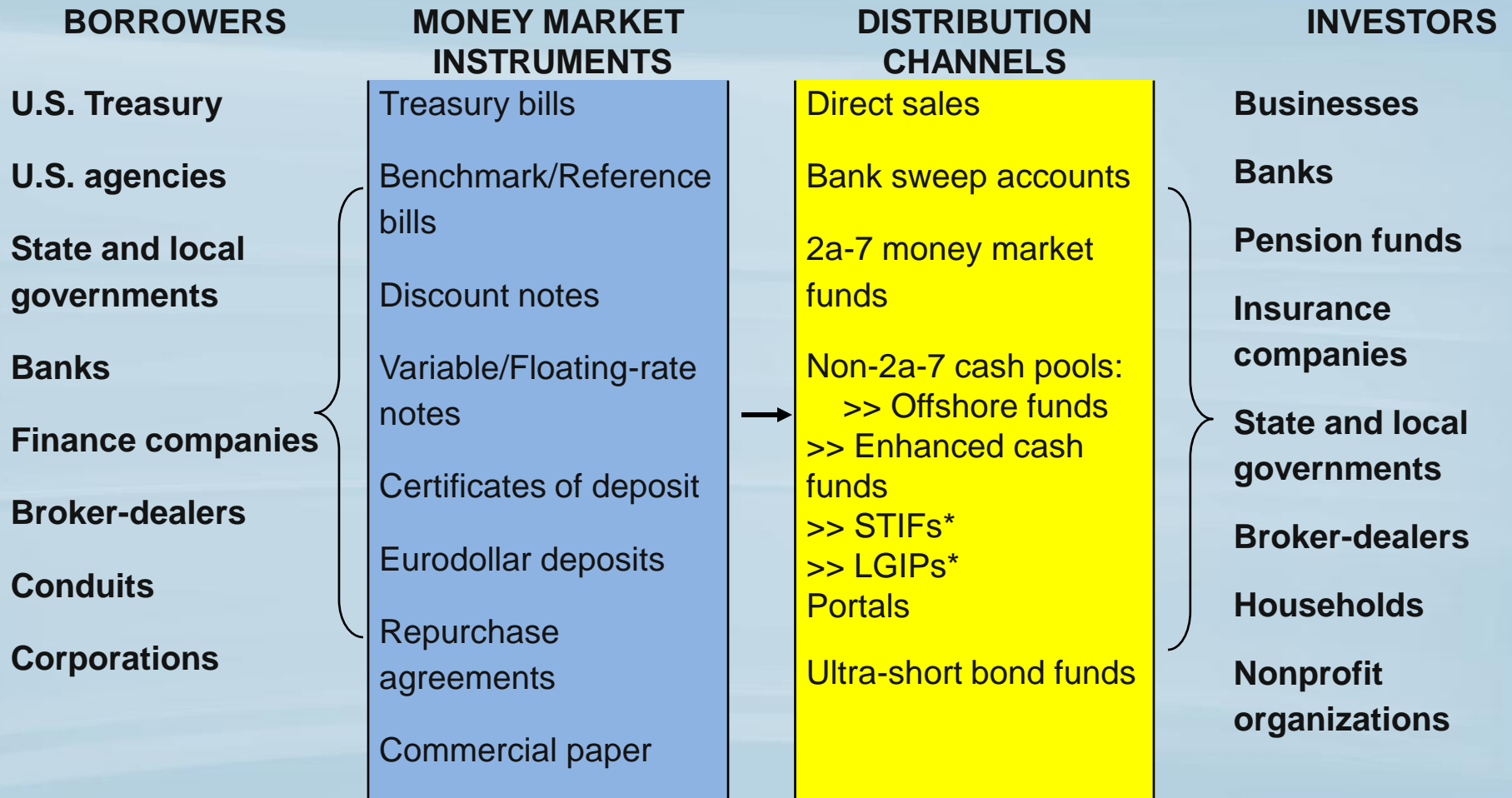
# Background of the Money Market Working Group

- Response to major market developments
  - SIVs
  - Bear Stearns and tri-party repo market
  - Reserve (credit) and Putnam (liquidity)
- Extraordinary government response
  - Treasury Guarantee Program
  - Various liquidity facilities

# Work of the Money Market Working Group

- Ongoing discussions with a wide array of those knowledgeable about and interested in the money markets
  - ICI money market fund members
  - Participants in the money markets, e.g., issuers, dealers
  - Investors
  - Academics
  - Regulators
- Studying experience of other pooled cash funds and other jurisdictions

# Structure of the U.S. Money Market



\* STIFs are short-term investment funds; LGIPs are local government investment pools.

Sources: Investment Company Institute and Treasury Strategies

# Selected Money Market Instruments

December 2008

	Total	Money market fund holdings	
	<i>Billions of dollars</i>	<i>Billions of dollars</i>	<i>Percentage of total</i>
<b>Total taxable instruments</b>	\$11,882	\$3,031	26%
Agency securities <sup>1</sup>	1,748	774	44
Commercial paper	1,599	629	39
Treasury securities <sup>2</sup>	2,473	591	24
Repurchase agreements <sup>3</sup>	2,381	552	23
Certificates of deposit <sup>4</sup>	2,192	353	16
Eurodollar deposits <sup>5</sup>	1,489	132	9
<b>Total tax-exempt instruments<sup>6</sup></b>	750	491	65

1. Debt issued by Fannie Mae, Freddie Mac, and the Federal Housing Finance Board due to mature by December 2009; category excludes agency-backed mortgage pools.

2. Marketable Treasury securities held by the public due to mature by December 2009.

3. Repurchase agreements with primary dealers; category includes gross overnight, continuing, and term agreements on Treasury, agency, mortgage-backed, and corporate securities.

4. Certificates of deposit are large or jumbo CDs, which are issued in amounts greater than \$100,000.

5. Category includes claims on foreigners for negotiable CDs and non-negotiable deposits payable in U.S. dollars, as reported by banks in the U.S. for those banks or those banks' customers' accounts. Values for customer accounts are for September 2008.

6. Category includes long-term debt issued by state and local governments. (VRDNs and TOBs, which are included in long-term debt in the Flow of Funds Accounts published by the Federal Reserve Board, are eligible to be held by money market funds under certain conditions.)

Sources: Federal Reserve Board, U.S. Treasury Department, Fannie Mae, Freddie Mac, Federal Housing Finance Board, and Federal Reserve Bank of New York

# Spread Between Three-Month LIBOR and Overnight Index Swap Rate\*

*Basis points, daily*

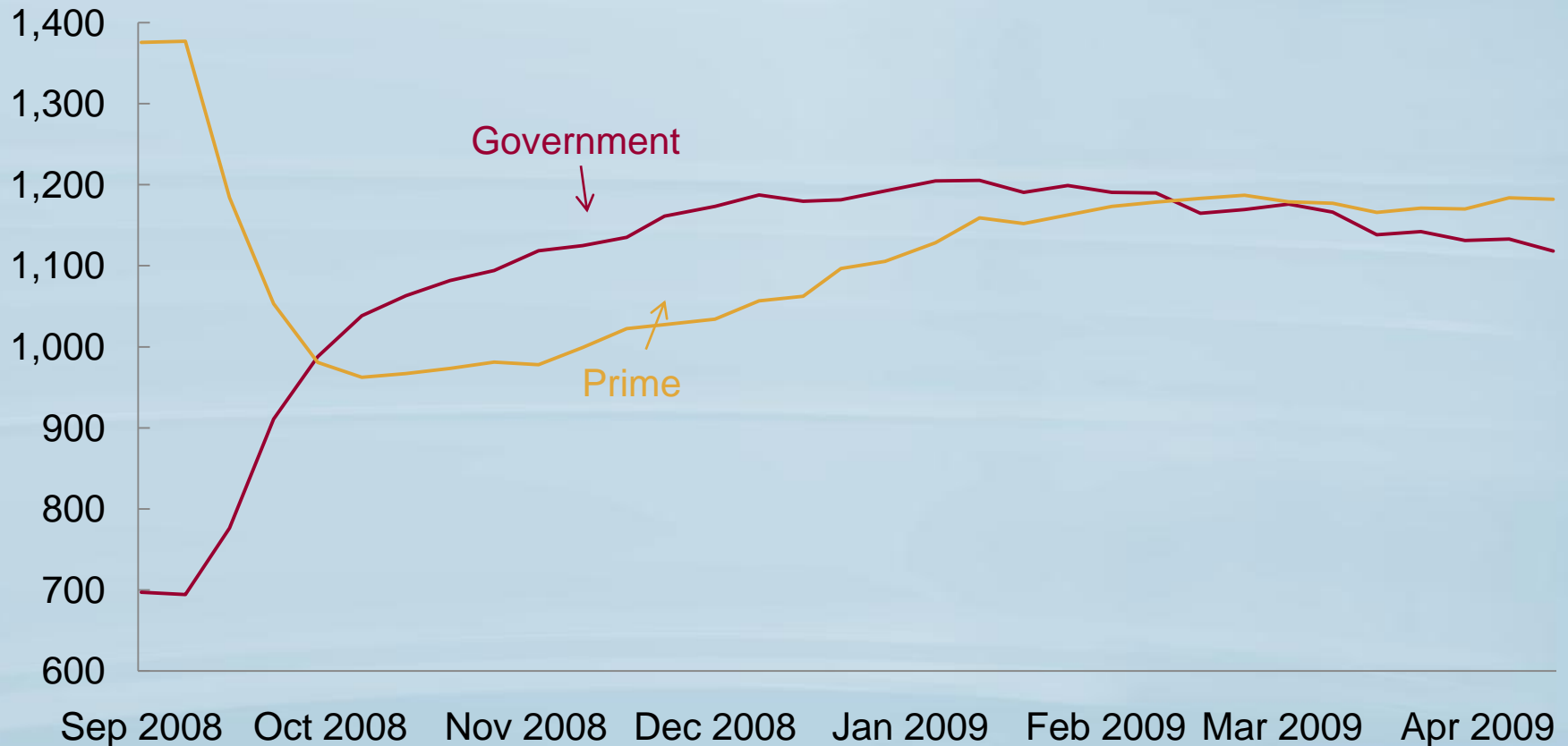


\* 90-day LIBOR (London Interbank Offered Rate) less the 90-day Overnight Index Swap (OIS) rate. An OIS is an interest rate swap with the floating rate tied to an index of daily overnight rates, such as the effective federal funds rate. At maturity, two parties exchange, on the basis of the agreed notional amount, the difference between interest accrued at the fixed rate and interest accrued by averaging the floating, or index, rate.

Source: Bloomberg

# Total Net Assets of Prime and Government Institutional Money Market Funds

*Billions of dollars, weekly*



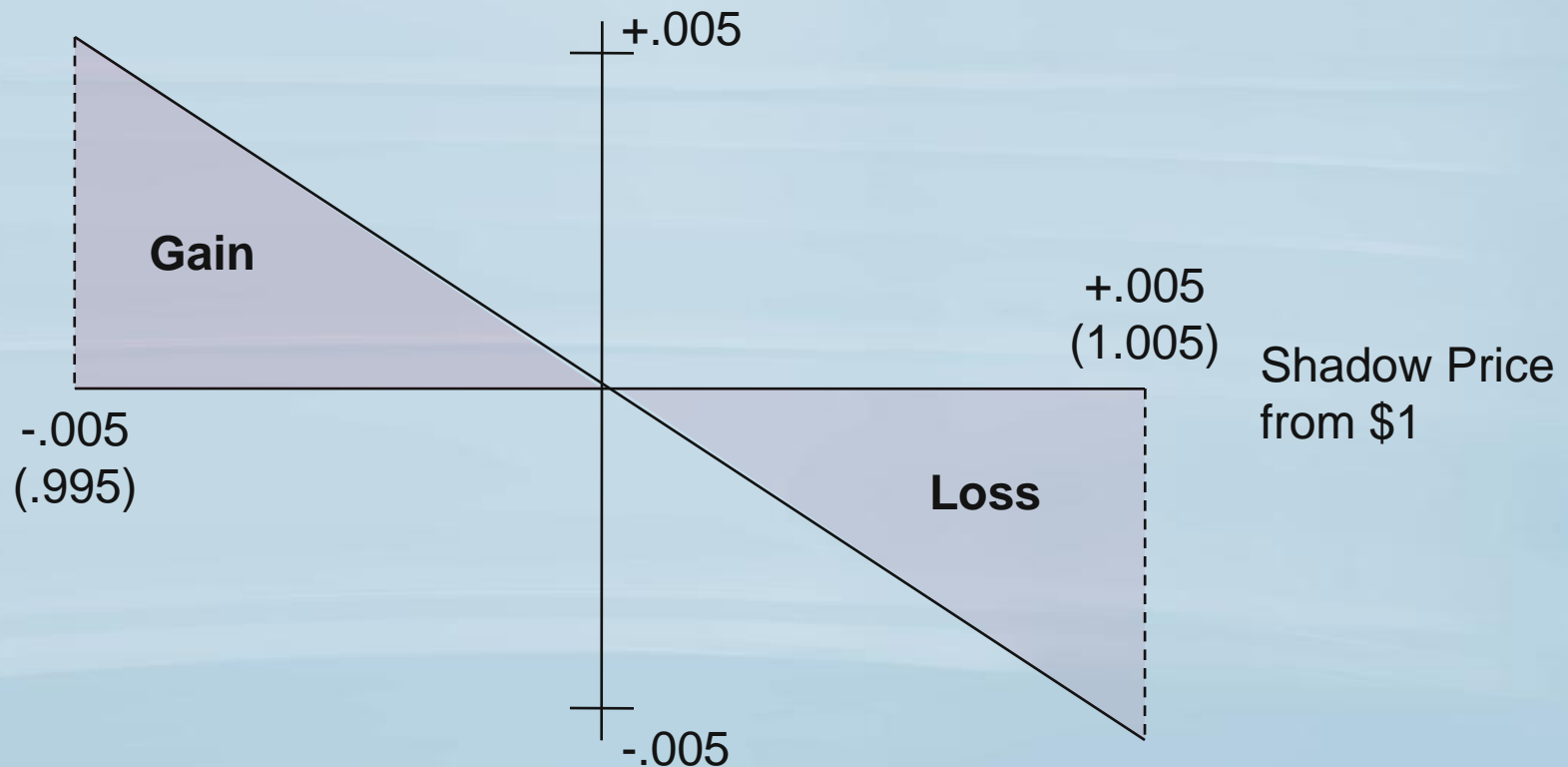
Source: Investment Company Institute

# Others' Suggestions for Money Market Reform

- Floating NAVs
  - Allow share price to fluctuate
  
- Concerns with these proposals
  - Investors will reject floating NAV money market funds
  - Floating NAV funds also can face strong investor outflows in periods of market turmoil.

# Schedule of Payoffs for Redeeming Shareholder

Payoff = \$1 - Shadow Price



# Example of How the Liquidity Put Can Have Value With a Floating Share Price

## Normal Market

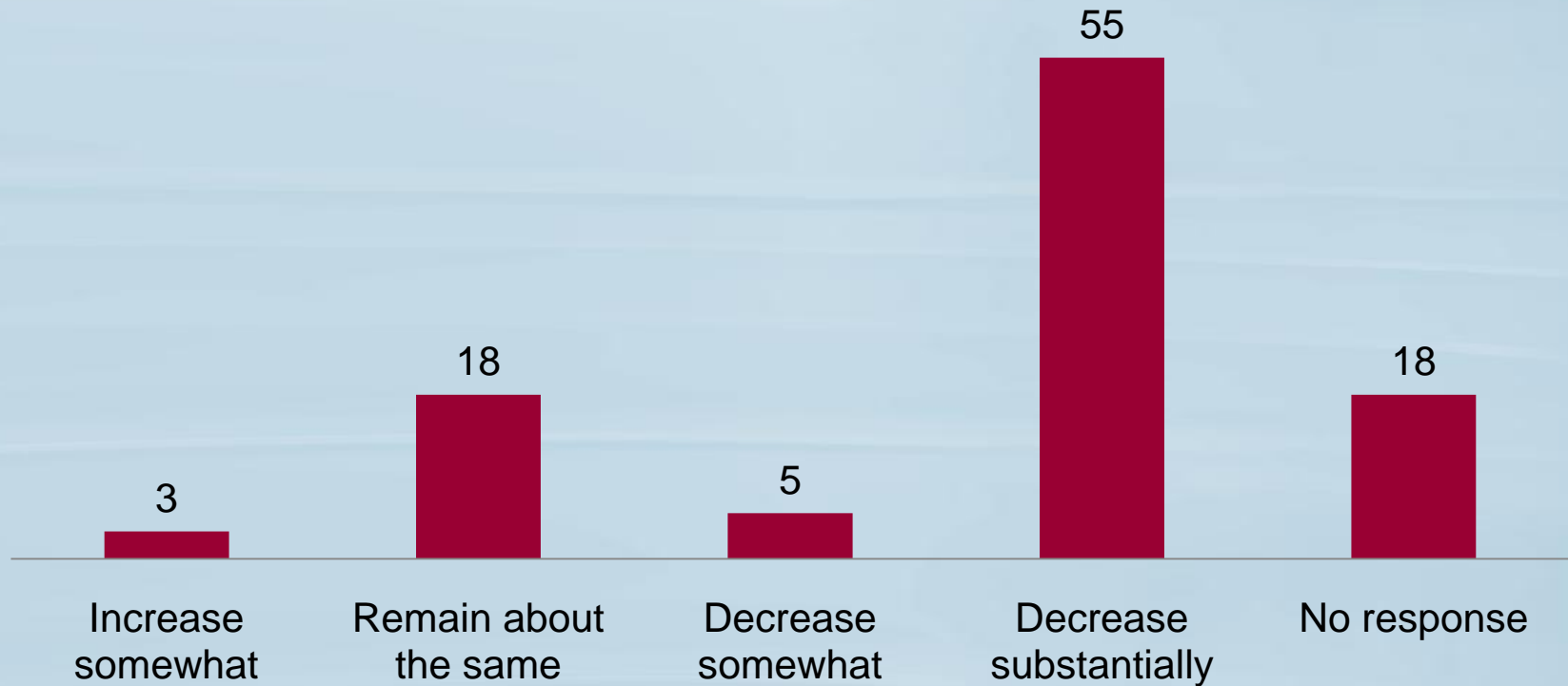
$\frac{\$1000 \times 10 \text{ units}}{10,000 \text{ Shares}}$	= \$1.00	\$1,000	\$1001.00	Ask
			\$999.00	Bid

## Stressed Market

$\frac{\$999 \times 10 \text{ units}}{10,000 \text{ Shares}}$	= \$1.00	\$999	\$1001.00	Ask
			\$997.00	Bid

# Institutional Cash Managers' Expected Usage of Floating-NAV Money Market Funds

*Percentage of Respondents, January 2009*

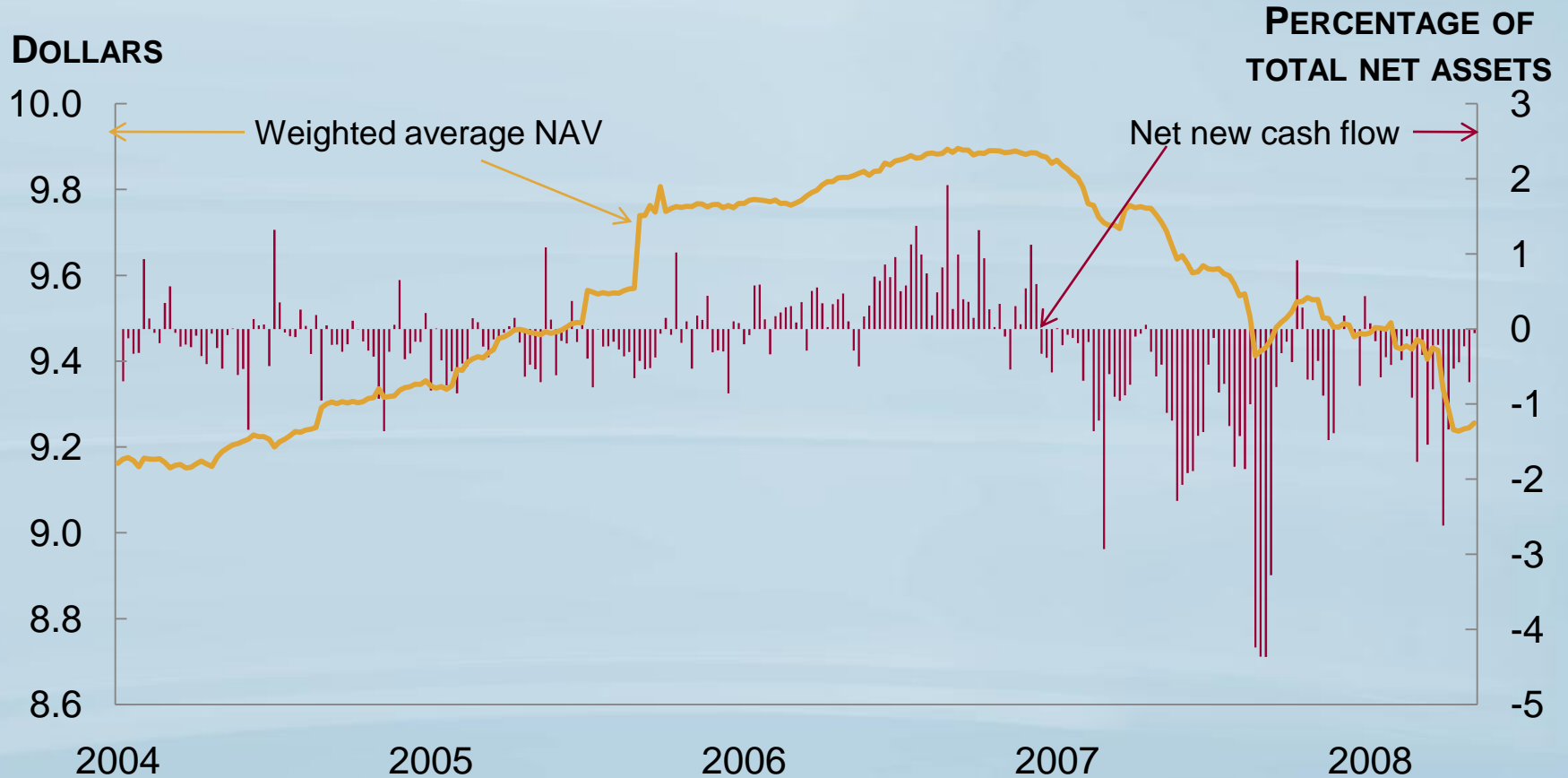


Note: Percentages do not add to 100 percent because of rounding.

Source: Treasury Strategies Inc. flash survey of 78 institutional cash managers on January 30, 2009. Of the 78 institutional cash managers, 43 were commercial, 13 were education-related, 13 were private, four were state and local governments, four were financial institutional, and one was unclassified.

# Weighted Average NAV and Net New Cash Flow of Ultra-Short Bond Funds

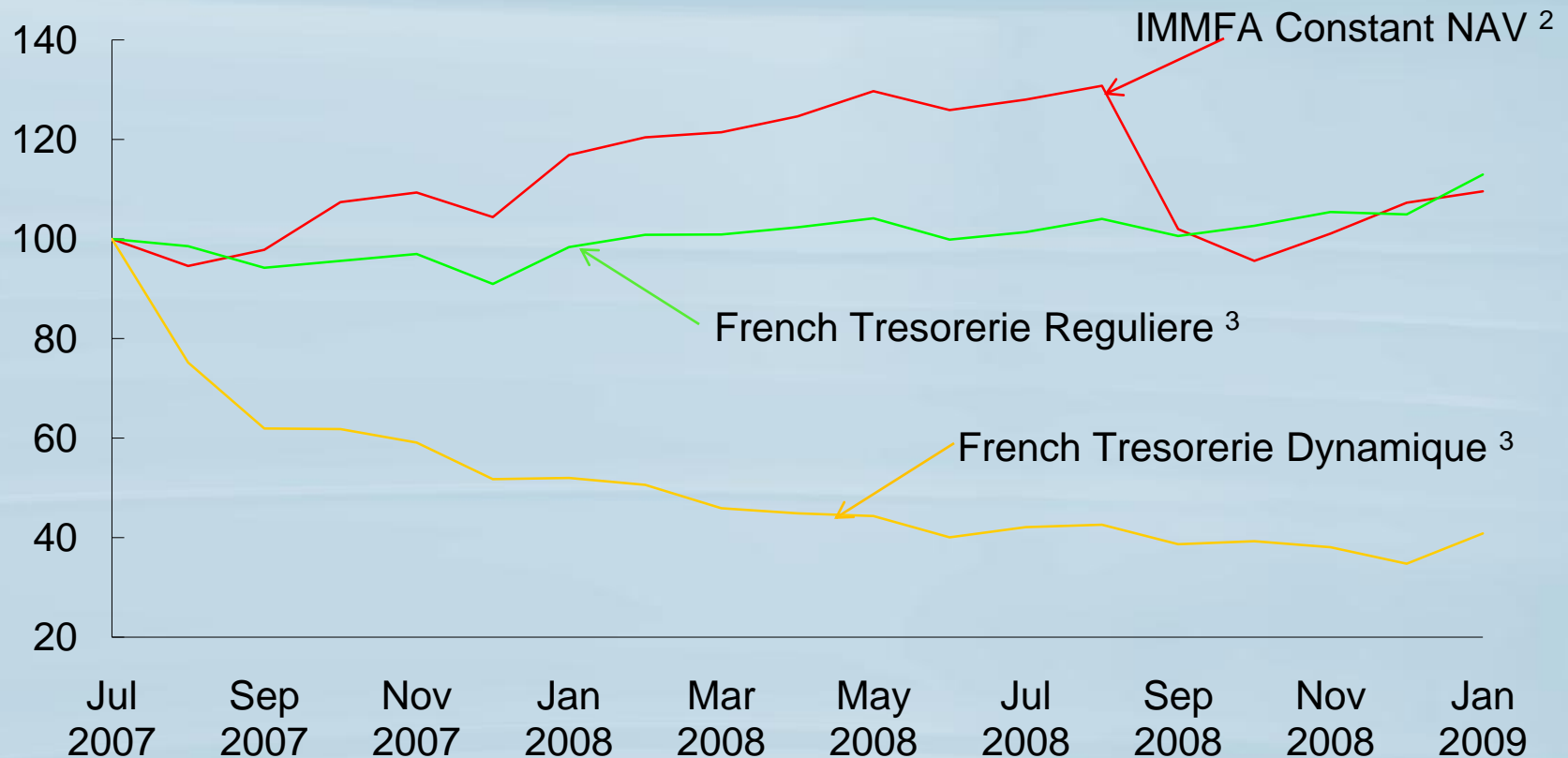
## Weekly



Sources: Investment Company Institute and Morningstar

# Growth of U.S., IMMFA, and French Money Market Fund Assets <sup>1</sup>

*Index=100, July 2007*



Sources: *iMoneyNet and Europerformance*

<sup>1</sup> IMMFA and French money fund assets converted to USD using month-end exchange rates as of January 2009

<sup>2</sup> IMMFA data excludes all government and treasury money fund assets

<sup>3</sup> All French money funds have a variable NAV. The Tresorerie Dynamique funds generally invest in a broader range of instruments than the Tresorerie Reguliere funds.

# Money Market Working Group Recommendations

- Impose liquidity requirements
  - Taxable Funds – daily liquidity test – 5 percent
  - All Funds – weekly liquidity test – 20 percent
  - Stress test requirement
- Tighten portfolio maturity limits
  - Dollar Weighted Average Maturity – limit of 75 days (currently 90 days)
  - Require new “spread WAM” – limit of 120 days
- Raise the credit quality standards
  - Require a “new products” or similar committee
  - Encourage advisers to follow best practices for determining minimal credit risks
  - Require advisers to designate and disclose 3 NRSROs
  - Prohibit investments in “Second Tier Securities”

# Money Market Working Group Recommendations

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- Address client risk
  - Require advisers to adopt robust “know your client” procedures
  - Require advisers to provide monthly website disclosure about client concentration levels and the risks, if any, that such concentration may pose to the fund

# Money Market Working Group Recommendations

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- Address the possibility of a “run” by authorizing a fund’s board to
  - Temporarily suspend redemptions and purchases of fund shares for a period of 5 days
  - Permanently suspend redemptions for funds preparing to liquidate

