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Money Market Reform

By JP Walsh, CFA, LL.M. Candidate 2015 | October 7, 2014

Money market funds ("MMFs") act as a secure and liquid cash management vehicle for retail and institutional investors. MMFs enable investors to gain access to higher returns than interest-bearing bank accounts while providing principal stability and liquidity. They have proven to be very popular amongst investors, garnering over $2.5 trillion in assets.

During the global financial crisis, the SEC recognized that fundamental reform was needed after structural issues became prevalent within MMFs. In 2008, one fund "broke the buck" which caused a run on several funds as contagion set in. As a run on all MMFs would have caused extensive panic throughout the global financial system, the Treasury Department stepped in with a temporary guarantee program. Consequently, the SEC decided to adopt a new set of rules to govern MMFs.

Regulators approved several reforms in 2010, which included more controls on liquidity, transparency, and credit screening. The latest and final round of reforms will complete the SEC's overhaul on how MMFs are regulated and operate. Mary Jo White, the Chairwoman of the SEC, says the goal of the reforms are to "reduce the risk of runs in money market funds…[which in turn] will make our markets more resilient...[and] protect investors and the financial system in a crisis".

The new rules impose more stringent requirements on the MMF industry. The two most important requirements from the latest reforms include the introduction of "gates" which will allow MMFs to charge redemption fees to investors in times of distress, and the requirement that certain institutional funds have a floating net asset value ("NAV").

Unlike other mutual funds, MMFs traditionally sought to maintain a stable NAV, typically $1.00, which assured investors that their initial investment did not decrease in value. The SEC has stated that the goal of the floating NAV is to give investors more information, which will help prevent investors from liquidating their investment all at once.

The new rules have proven to be controversial even within the SEC. The reforms passed by a narrow 3-2 margin, and the two dissenting commissioners fear that allowing funds to suspend charge redemption fees may actually spark runs and divert less sophisticated investors to riskier investment vehicles.

The final adoption is a result of more than three years of debate as fund management companies were resistant to the proposed changes. The move to exempt retail and government funds from the floating NAV rules is seen as a compromise by the SEC in order to get the reforms across the line.

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The SEC is allowing all fund management companies two years to implement all aspects of the new rules.