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Statement No. 342

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Statement of the Shadow Financial Regulatory Committee on

Money Market Funds – A Solution?

May 13, 2013

There has been an ongoing controversy over whether money market funds (MMFs) pose a possible risk of systemic runs because of the prevailing policy of redeeming shares at a fixed par value of $1 even if the net asset value (NAV) of a share has fallen below that number. The risk is that shareholders may rush to redeem at the par value before the fund is forced by declines in portfolio value to "break the buck" and redeem at the lower NAV.

It has been reported that the Securities and Exchange Commission (SEC) is considering a proposed resolution to the question by making a distinction between two kinds of funds: 'government' funds (invested only in government securities) and 'prime' funds (invested more broadly in corporate and other securities), and require only the prime funds to redeem at a 'floating' NAV. Many MMFs are already disclosing their daily NAV, which enables shareholders to judge whether they are approaching a break point, and the Committee would support adopting a rule to that effect.

Institutional shareholders with large accounts are far more likely to respond to small declines below a $1 par and redeem, so some in the industry have urged that the floating NAV apply to all institutional funds, a position the committee has previously endorsed (Statement No. 309, February 14, 2011). There is a better case to be made for allowing sponsors of retail prime funds (with much smaller accounts) to continue a policy of redemption at par if they so choose (incurring at times the possible cost of making some contributions to the fund's capital). How tenable that policy would prove to be, in the light of daily posting of the portfolio NAV, would be determined by management's investment policy and willingness to absorb some capital losses in order to maintain par redemption. But the decision could be left to management judgment in individual retail funds, rather than a universal regulatory mandate, with little prospect of wide-spread runs posing systemic risk to the financial stability of the United States. This course might facilitate an end to the SEC deadlock on the issue.