Money Market Funds Are One of the Safest Investments

AN OPEN LETTER FROM CHARLES R. SCHWAB

Regulators and other government officials have carelessly charged money market funds with being "brittle," "vulnerable to runs," and "shadow banks." Before they create undue alarm about the funds' safety among the 50 million or more investors who use them, it is important to remind ourselves what money funds are...and are not.

Money market funds are open and transparent investments that have been regulated by the SEC since the 1970s. There are more than 500 of them in operation today, and since 1990, they have paid investors $260 billion more in dividends than what investors would have received in interest had that money been kept in a bank deposit account.

Money market funds are permitted by regulators to invest only in short-term, fixed income securities that must be of the highest credit rating, meaning securities issued by government agencies, municipalities and large, healthy corporations. At least 97 percent of a fund must be held in securities with the highest short-term credit ratings.

In addition to oversight by the SEC, all money market funds managed under the Investment Company Act of 1940 are overseen by an independent board of trustees, independent legal counsel and independent auditing firms. These funds are generally operated day to day by well-known investment management companies. Many banks also operate money funds.

Money market funds have a four-decade-long track record of security and safety, and are considered by many experts to be one of the safest constructed investments available to investors. They are not brittle or susceptible to runs, and are not shadow banks. In 2008, at the depth of the financial crisis, only one money fund lost value for its clients. It lost one percent of its value; that is just one penny of the $1.00-per-share price. In the history of the money fund industry, this is only the second time a fund broke the $1.00-per-share value. By contrast, just since 2008, more than 500 banks and credit unions have failed, costing investors and taxpayers more than 80 billion dollars.

> The chart below shows many of the critical differences between money funds and other financial institutions. The contrasts are telling and worth a quick review:

- Government regulators say that strong capital requirements are a good thing. I agree. How about 100 percent? That's the capital ratio you'll find in money funds.

- Money market funds are not in the business of leveraging their holdings. They have no liabilities, only assets. Shareholders of money funds are investing in underlying securities. One hundred percent of assets held in a money fund belong to the fund and hence to individual shareholders. In contrast, banks' daily business is to take in deposits, calculate risk and lend money to people for such things as mortgages, cars and businesses. Insurance companies and credit unions operate similarly to banks, with many different kinds of assets and liabilities.

- In 2010, new SEC rules were put in place that significantly increased the mandated liquidity requirements for money market funds—in other words, how quickly the underlying assets can be converted to cash. Today, 30 percent of assets must mature in seven days or less, and 10 percent within one day, making them the most liquid investments available. The industry currently holds around $800 billion in instruments that mature in seven days or less. This level of liquidity helps ensure that money market funds can effectively meet spikes in redemptions.

- The weighted average maturity of assets held in a money fund is required by law to be 60 days or less. A reasonable estimate for bank assets is three-plus years, and many bank asset maturities extend out to decades, as is the case with the 30-year mortgages they hold.

- Money funds are transparent. SEC rules require money funds to publish their individual holdings every month for you to view. They are also published in shareholder reports. Banks and other financial institutions do not have the same obligation and likely couldn't provide that information to you even if you requested it. Rather, they are free to invest and loan however they want, and you have no visibility into those choices.

- Banks and other depository institutions offer FDIC insurance up to $250,000. Money market funds do not carry deposit insurance—precisely because of the degree of safety, regulation, limitations on what can be held in a money fund, and the fact that they are 100 percent capitalized and without leverage. Money market funds are securities and are subject to risk—investors understand this—but the risks are disclosed, of short duration and managed through high-quality investments.

The campaign to scare owners of money fund shares is neither accurate nor wise. Over many decades, money funds have been a safe, solid and transparent investment tool for individuals to manage their short-term cash. Over the past year, money market funds have weathered multiple spikes in redemptions—prompted by the debt ceiling debate last summer, the downgrade of US debt and the ongoing euro zone crisis — without any problems. The new rules are working.

Investors would be better served if regulators would focus their attention where the risky components of the financial services reside and where there is little transparency—swaps, commodities clearing, structured investment vehicles, fraud and the Madoffs of the world. Money market funds have proven themselves through thick and thin.

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How Money Funds Are Very Different Than Banks and Other Deposit Institutions

HOW MONEY FUNDS ARE VERY DIFFERENT THAN BANKS AND OTHER DEPOSIT INSTITUTIONS	Prime Money Funds	US Government Only Money Funds	US Banks (average)	US Insurance Companies (average)	Federal Credit Union Banks (average)
Capital Ratios (Tier One Capital Ratio)	100%	100%	10%	10%	9%
Leverage	None	None	90% of assets	90% of assets	91% of assets
Liquidity Requirements Mandated	Yes	Yes	No	No	No
Weighted Average Maturity of Assets	60 days or less	60 days or less	3+ years*	7+ years*	4+ years*
Transparency (Monthly report of assets and liabilities on website)	Yes	Yes	No	No	No
Deposits Guaranteed by US Government	None	None	Deposits up to $250,000	Deposits up to $250,000	Deposits up to $250,000

* My conservative estimates.