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## MUTUAL FUNDS: INVESTING IN AMERICA'S

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## ABOUT II

### Frequently Asked Questions about Money Market Funds

#### *What are money market funds, and how do investors use them?*

A money market fund is a type of mutual fund that invests in high-quality, short-term securities that present minimal credit risk. These funds also pay dividends that generally reflect short-term interest rates. Although the net asset value (NAV) per share of a traditional mutual fund changes daily in response to market factors, money market funds are structured to avoid these changes by seeking to maintain a stable share price, typically \$1.00 per share.

Investors use money market funds for a variety of reasons. Like other mutual funds, money market fund shares can be bought or sold at any time. Money market funds also often provide check-writing privileges for shareholders. Some investors use money market funds as a "parking place" for cash between investments because money market fund yields are typically competitive with those of most savings accounts.

Due to extraordinary events in the financial markets, on September 19 the U.S. Department of the Treasury announced an emergency, temporary guarantee program to protect shareholders of money market mutual funds from losses if their funds are unable to maintain a \$1.00 net asset value (known as "breaking the buck"). [Click here for FAQs on the program.](#)

#### Additional Information about Money Market Funds

- [FAQs on Treasury's Guarantee Program](#)
- [Media Advisory: Reporting on Money Market Mutual Funds](#) (Investment Company Institute)
- [Money Market Funds](#) (U.S. Securities and Exchange Commission)
- [Money Market Mutual Fund Assets](#) (Investment Company Institute)

#### *What types of investments do money market funds hold?*

Federal regulations prohibit a money market fund from acquiring any investment that is not (1) short-term, (2) determined to present minimal credit risks, and (3) either highly rated or determined to be comparable in quality to highly rated securities. "Short-term" means that the money market fund can receive its full principal and interest within 397 days. Moreover, regulations prohibit the average maturity of the fund's investments from exceeding 90 days, and almost all funds maintain a much shorter average maturity.

Taxable money market fund investments include U.S. Treasury securities, federal agency notes, certificates of deposit, and commercial paper. Money market funds also may invest in repurchase agreements that are collateralized fully by U.S. Treasury and agency securities or other high quality securities.

Commercial paper consists of short-term notes issued by a wide variety of corporations such as domestic and foreign firms, banks, finance companies, and issuers of commercial paper. Asset-backed commercial paper, which is a type of commercial paper backed by a pool of assets, accounts for about half of the total commercial paper outstanding.

Typically, tax-exempt money market funds, which seek to pay dividends that are exempt from federal income tax and/or state income tax, invest in instruments issued by state and local governments ("municipal securities").

### ***How do money market funds seek to maintain a stable \$1.00 net asset value?***

Money market funds are stringently regulated by the U.S. Securities and Exchange Commission (SEC) pursuant to Rule 2a-7 under the Investment Company Act of 1940. Rule 2a-7 includes several conditions intended to stabilize a fund's share price at \$1.00. These conditions limit risk in a money market fund's portfolio by governing the credit quality, diversification, and maturity of money market fund investments.

- **Credit Quality:** Money market funds are required to hold high-quality securities. For taxable money market funds, at least 95 percent of a money market fund's assets must be invested in securities that received the highest short-term rating from two NRSROs (unless only one NRSRO rates the security or issuer of debt); or securities of comparable quality. Not more than 5 percent of a money market fund's investments may be in securities that received the second-highest short-term rating categories.
- **Diversification:** Money market funds must maintain a diversified portfolio. This requirement limits a fund's economic exposure to any single issuer. For instance, in general, money market funds may not invest more than 5 percent of assets in the securities of any single issuer (1 percent, if the issuer has received ratings in only the second highest short-term rating category), with the exception of securities issued by the federal government or its agencies.
- **Maturity:** Money market funds must invest in securities that are considered "short-term." In general, money market funds cannot acquire a portfolio security with a remaining maturity of greater than 397 days. In addition, a money market fund's weighted average maturity (WAM)- an average of the maturities of all securities held in the portfolio, weighted by each security's percentage of net assets-must not exceed 90 days.

### ***I'm hearing that a money market fund has "broken the buck." What does that mean?***

A money market fund "breaks the buck" when it is unable to repay its \$1.00 NAV per share. On September 16, a money market fund announced that its NAV that day was 97 cents, due to a sharp writedown in some securities the fund held. In addition, in 1994, a small institutional money fund "broke the buck"; investors received 96 percent of their principal.

### ***What happens to investors when a fund "breaks the buck"?***

To date, money market fund shareholders have lost only a few pennies on the dollar. When a fund

"breaks the buck," shares are redeemed and investors are repaid at the fund's NAV, calculated on the day they place their redemption order.

On September 19, 2008 the U.S. Treasury announced a new, temporary guarantee program, that will insure the holdings of any publicly offered eligible money market mutual fund-both retail and institutional-that pays a fee to participate in the program. Funds are not required to participate in this program. [Click here for FAQs on this program.](#)

#### ***What happens to investors when a money market fund closes and liquidates?***

In some cases, a fund will close to new investors and distribute its assets to investors, in accordance with the distribution terms in its prospectus. A fund might do this to provide equitable treatment to all investors in the face of significant redemption pressure that might lead to a forced sale of the fund's assets.

#### ***Does the federal government insure money market funds?***

An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation. On September 19, 2008 the U.S. Department of Treasury announced a program that will guarantee the holdings of any publicly offered eligible money market mutual fund-both retail and institutional-that pays a fee to participate in this program. The program is voluntary, and each fund determines whether to participate. [Click here for FAQs on this program.](#)

#### ***Does the money market fund's investment adviser or sponsor insure the fund?***

An investment in a money market fund is not insured or guaranteed by the fund's investment adviser or sponsor. However, in many cases, investment advisers and their affiliates have provided financial support to their money market funds.

#### ***How many money market funds are there?***

Money market mutual funds accounted for 805 of the 8,073 funds available as of July 2008, according to ICI's monthly survey of the U.S. fund industry.

#### ***What is the percentage of total mutual fund assets held in money market funds?***

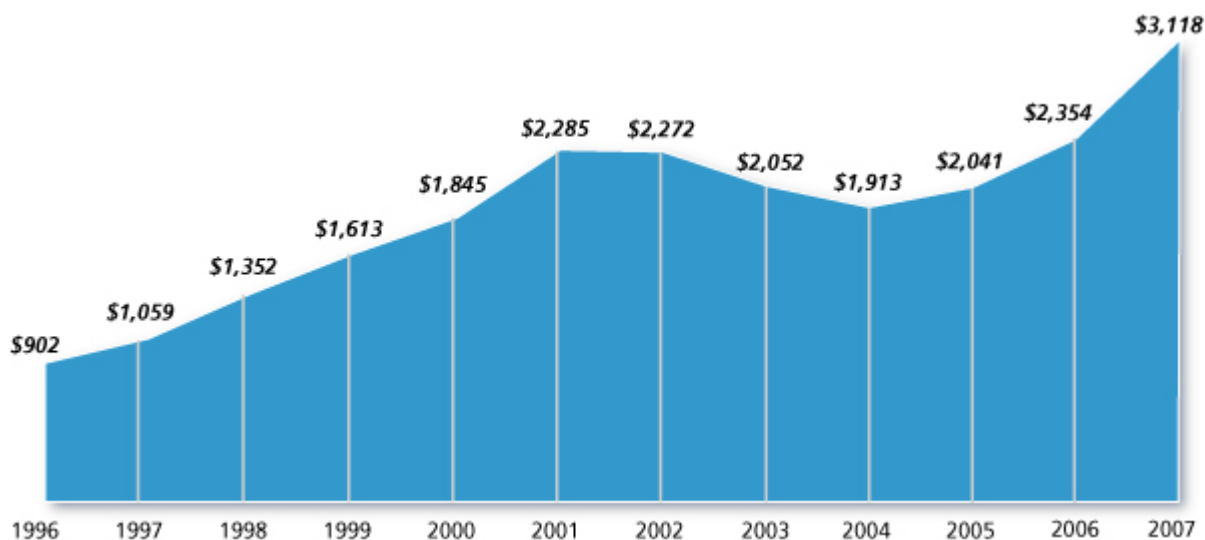
Money market fund assets account for 30 percent of all mutual fund assets. As of July 2008, approximately \$3.5 trillion was invested in money market funds. By comparison, stock funds account for 49 percent (\$5.7 trillion) of overall assets. (A [weekly report on retail and institutional money market fund assets](#) can be found on the Institute's website.)

#### ***What are the recent trends in money market fund assets?***

Assets of money market mutual funds have increased significantly since 2004, rising about 82 percent to a level of \$3.5 trillion by July 2008. This increase primarily reflected very significant inflows to institutional money market funds, and to a lesser extent, inflows to retail money market funds in 2007.

#### **Money Market Fund Assets**

*(billions of dollars)*



### ***What are institutional money market funds?***

Institutional funds are held primarily by businesses, governments, institutional investors, and high-net worth households. As of July 2008, institutional funds hold 63 percent of all money market fund assets.

### ***What are retail money market funds?***

Retail funds are offered primarily to individuals with moderate-sized accounts. As of July 2008, retail money market funds hold around 37 percent of all money market fund assets.

### ***Are "enhanced cash" management products the same as money market funds?***

No. "Enhanced cash" products is a general term that refers to funds that are typically not registered with the SEC and that seek yields slightly higher than those of money market funds. In seeking those yields, however, enhanced cash products can exceed the SEC rule restrictions imposed on money market funds governing the credit quality, diversification, and maturity of investments. These products are typically offered to institutions as private placements, separate accounts, or certain types of trusts. They also may be referred to as "money market-plus" funds, "money market-like" funds, or "enhanced yield" funds.

### ***What are "government investment pools" or "local government investment pools"?***

"Government investment pools" (GIPs) or "local government investment pools" (LGIPs) typically refer to state- or county-operated funds offered to cities, counties, school districts, and other local and state agencies so they can invest money on a short-term basis. The agencies expect this money to be available for withdrawal when they need it to make payrolls or pay other operating costs. The majority of these products currently available is not registered with the SEC, and therefore is not subject to SEC rules for money market funds, which govern the credit quality, diversification, and maturity of investments. Investment guidelines and oversight for GIPs and LGIPs also may vary from state to state.

### ***What role do boards play in overseeing money market funds?***

A money market fund's board of directors is primarily responsible for ensuring that the fund complies with the SEC's conditions to limit risk in the fund's portfolio. The board establishes written guidelines

and procedures reasonably designed to stabilize the fund's \$1.00 NAV. The board also must exercise adequate oversight (e.g., through periodic reviews of fund investments) to ensure that those guidelines and procedures are being followed.

### ***What is the board's responsibility in the event that a security in a money market fund's portfolio is downgraded or defaults?***

If a security in the fund's portfolio is downgraded, the fund's board (or its delegate, such as the fund's adviser) must promptly determine whether the security continues to present minimal credit risk and must cause the fund to take whatever action is determined to be in the fund's best interests. If a security defaults, the fund must dispose of the security as quickly as possible, unless the fund's board determines that to do so would not be in the fund's best interests.

When a downgrade, default, or other development threatens to lower the fund's NAV below \$1.00, an affiliate of the fund may take certain actions to prevent this occurrence. In some cases, the fund's adviser or affiliate will purchase the troubled security. This type of action should be brought to the board's attention, and in some instances, may require SEC approval. ([Click here for a FAQs on Treasury money market fund guarantee program.](#))

### ***What are credit enhancements?***

Issuers of securities use credit enhancements to raise the credit rating of a security by backing it with the credit of a third party. Credit enhancements (e.g., bond insurance and bank letters of credit) can help lower the risk of default, improve liquidity, and reduce the interest rate that issuers must pay.

Bond insurance, for example, unconditionally guarantees the payment of principal and interest on the bond if the issuer of the bond defaults. Generally, this guarantee improves the credit rating of the bond, because insured bonds typically are rated based on the credit of the insurer rather than the underlying credit of the issuer.

Tax-exempt money market funds often hold municipal securities insured by a bond insurance company. If a bond insurer is downgraded, it does not necessarily mean that the security is ineligible to be held in the money market fund. However, if the bond insurer is downgraded to the point where neither the insurer's rating nor the bond issuer's rating meets the standards for money market fund holdings, a money market fund must promptly determine whether it may continue to hold these securities.

### ***Where can I find more information on money market funds?***

ICI offers a [guide to understanding mutual funds](#) as part of its Investor Awareness series; conducts [research on U.S. household ownership](#) of money market and other types of mutual funds; and tracks [assets and other statistical data](#) on money market and other types of mutual funds.

*September 2008*