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### Credit FAQ: How Are Events In The Financial Markets Affecting Money Market Funds?

Primary Credit Analysts:

Peter Rizzo, New York (1) 212-438-5059;

[peter\\_rizzo@standardandpoors.com](mailto:peter_rizzo@standardandpoors.com)

Francoise Nichols, Paris (33) 1-4420 7345;

[francoise\\_nichols@standardandpoors.com](mailto:francoise_nichols@standardandpoors.com)

Secondary Credit Analysts:

Joel C Friedman, New York (1) 212-438-5043;

[joel\\_friedman@standardandpoors.com](mailto:joel_friedman@standardandpoors.com)

Andrew Paranthoienne, London (44) 20-7176-8416;

[andrew\\_paranthoienne@standardandpoors.com](mailto:andrew_paranthoienne@standardandpoors.com)

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In light of recent actions taken by some money market funds to freeze redemptions and implement payments in kind in lieu of cash distributions--and some funds' failure to maintain a stable \$1.00 per share net asset value (NAV; "break the buck"), Standard & Poor's Rating Services has taken several rating actions on money market funds during the past two weeks. Questions remain as to fund managers' reaction to the current market crisis, as well as future repercussions for investors globally. (See also "Money Market Funds Tackle 'Exuberant Irrationality,'" published Sept. 30, 2008, on RatingsDirect.)

### Frequently Asked Questions

#### What actions have money market fund managers taken to support their funds' NAVs?

During the past year, several financial institutions that sponsor money market funds have done one or more of the following: purchase distressed assets at amortized cost, obtain or provide credit support agreements from highly rated institutions (i.e. A-1 or better), make cash infusions into the fund, suspend redemptions, or distribute redemptions-in-kind.

#### What other strategies have fund managers implemented to navigate the latest market disruption?

The recent events included a dramatic increase in shareholder redemption requests at many money market funds. As a result, many managers have taken at least one of the following defensive steps to weather the current storm: continued to closely monitor and reevaluate investments in commercial paper; decreased weighted average maturity (WAM) of their funds by investing in short-term, overnight paper as securities mature; increased their funds' allocations to government-guaranteed instruments; increased diversification among sectors and issuers; or increased communication to shareholders.

## Did exposure to Lehman Brothers Holdings Inc. cause Reserve Prime to "break the buck?"

Yes, investments in Lehman coupled with material shareholder redemptions (a run on the fund) caused the Reserve Primary Fund to "break the buck." The fund had a \$785 million exposure to Lehman Brothers at the time of Lehman's default and during the course of the two days, shareholders redeemed more than 60% of its asset base (more than \$40 billion), making it necessary for managers to sell securities in a dislocated market.

## Are other 'AAAm' rated money funds in jeopardy of breaking the buck?

Although some funds are currently under market pressure, all rated money market funds are within 'AAAm' parameters. The only funds currently on CreditWatch are the Reserve funds listed below.

## What impact does the U.S. Treasury's plan to offer a guaranty program for money market funds and the Federal Reserve Board's Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility have on Standard & Poor's principal stability fund ratings (PSFRs)?

We believe the U.S. Treasury's plan to provide a guaranty program for money market funds will help restore investor confidence and liquidity. For money market funds (taxable and nontaxable) that sign up for the program by Oct. 8, 2008, the Treasury Temporary Guarantee Program for Money Market Funds will protect the shares of all money market fund investors as of Sept. 19, 2008. We will review each rated money market fund that signs up for the program on a case-by-case basis to determine if the amount of support provided by the U.S. Treasury is sufficient to protect against fund rating actions due to deteriorating market conditions.

We also believe the Federal Reserve Board's creation of the Asset-Backed Commercial Paper (ABCP) Money Market Mutual Fund Liquidity Facility (AMLF) will help improve liquidity and pricing for ABCP held in money market funds. The Federal Reserve Bank of Boston (FRBB) administers the AMLF. Because advances under the program are nonrecourse to the FRBB once an eligible borrower has borrowed under this facility, it is at no risk of loss on the eligible ABCP unless the ABCP is deemed to be nonconforming. We believe that rated money market funds that use this structure will have a greater liquidity cushion and will be more able to meet increased redemptions by selling their ABCP exposures at amortized cost.

## What fund rating actions has Standard & Poor's taken during the past two weeks?

The fund rating actions we took during the past two weeks are as follows:

- Reserve Funds - Primary Fund: To 'Dm' from 'AAAm' on Sept. 16, 2008;
- Reserve International Liquidity Fund Ltd.: To 'Dm' from 'AAAm' on Sept. 16, 2008;
- Colorado Diversified Trust (CDT): To 'Dm' from 'AAAm' and then to NR on Sept. 16, 2008;
- Reserve Funds - Interstate Tax Exempt Fund: To 'AAAm/Watch Neg' from 'AAAm' on Sept. 16, 2008;
- Reserve Funds - Primary II Fund: To 'AAAm/Watch Neg' from 'AAAm' on Sept. 16, 2008;
- Reserve Funds - Treasury & Repo Fund: To 'AAAm/Watch Neg' from 'AAAm' on Sept. 16, 2008;
- Reserve Funds - U.S. Government Fund: To 'AAAm/Watch Neg' from 'AAAm' on Sept. 16, 2008;
- Reserve Funds - U.S. Government II Fund: To 'AAAm/Watch Neg' from 'AAAm' on Sept. 16, 2008;
- Reserve USD International Government Fund Ltd.: To 'AAAm/Watch Neg' from 'AAAm' on Sept. 16, 2008;
- Reserve USD International Treasury & Repo Fund Ltd.: To 'AAAm/Watch Neg' from 'AAAm' on Sept. 16, 2008;
- Reserve USD International Treasury Fund Ltd.: To 'AAAm/Watch Neg' from 'AAAm' on Sept. 16, 2008;
- Reserve Yield Plus Fund: To 'AAAf/S1+/Watch Neg' from 'AAAf/S1+' on Sept. 16, 2008;
- Putnam Prime Money Market Fund: To 'AAAm/Watch Neg' from 'AAAm' on Sept. 18, 2008;

- Putnam Prime Money Market Fund: To 'AAAm' from 'AAAm/Watch Neg" and then to NR on Sept. 25, 2008, as it was absorbed by the 'AAAm' rated (Federated) Prime Obligations Fund.

### Are investments in 'AAAm' rated European and Offshore money market funds guaranteed?

No. Unlike U.S. domestic 2a-7 money market funds, European and offshore funds will not benefit from the U.S. Treasury's guarantee program. Nevertheless, portfolios of 'AAAm' rated European and offshore money market funds adhere to extremely strict investment guidelines in terms of credit quality, interest rate risk exposure, diversification, and liquidity of instruments. Although investments in these funds are not guaranteed, the funds' investment philosophy and portfolio structure allow them to exhibit extremely strong capacity to maintain principal stability and to limit exposure to principal losses due to credit, market, and liquidity risks.

Offshore fund managers have remained vigilant in their provision of daily liquidity to shareholders and have slightly increased their liquidity facilities during the past two weeks. Most fund groups, as reported to us, had on average 15%-25% of their portfolios in overnight liquidity facilities. Some, as a result of a dynamic shareholder base, have increased that to 20%-30%. There have been only a very few occasions where fund managers have been required to sell securities to meet client redemptions. To date, there have not been any rating actions on any of the more than 120 European and offshore managed 'AAAm' rated funds as a result of the recent market turmoil.

### What does a Standard & Poor's PSFR address, and how is it different from a traditional debt rating?

Our rating on money market funds (also called PSFRs) addresses a fund's ability to maintain principal stability--that is, to maintain \$1 per share NAV--and limit fund exposure to losses due to credit, market, and/or liquidity risks. The ratings range from 'AAAm' (extremely strong capacity to maintain principal stability) to 'Dm' (failure to maintain principal stability, resulting in a realized or unrealized loss of principal). The 'm' distinguishes principal stability fund ratings from Standard & Poor's debt ratings, which usually do not include subscripts. A principal stability fund rating is not directly comparable to a debt rating--the objective of which is to indicate a borrower's ability to repay principal and interest on a timely basis--because of differences in rating criteria and the investment characteristics and creditworthiness of portfolio investments.

### How often does Standard & Poor's review its PSFRs?

We maintain weekly surveillance on all PSFRs, including the review of all fund holdings and pertinent summary information. If there is a specific event that we perceive might affect the rating, we immediately review it. Additionally, fund analysts maintain frequent contact with the portfolio management team throughout the year and conduct annual management review meetings.

### Has Standard & Poor's ever changed ratings on a money market fund?

We have been assigning ratings to money market funds since 1984. We rate funds on a request basis and historically we have usually been requested to rate institutional money market funds. Nearly all of our current PSFRs are assigned to funds for institutional investors.

During this 24-year period and including last week's actions, we have upgraded or downgraded approximately 30 money market funds and placed more than a dozen on CreditWatch with negative implications. We currently rate more than 525 money market funds in the U.S. and Europe. The Reserve Prime fund was the first 'AAAm' rated SEC-registered money fund to lose principal value. Since the inception of money market funds in the early 1970s, prior to last week, there had only been one instance in which a U.S.-registered money market fund paid out less than \$1.00 per share NAV. In 1994 Community Asset Bank, an institutional money fund that we did not rate, paid out \$0.96 a share. Over the years, there have been more than 50 SEC-registered money market funds in which sponsors took preemptive measures to maintain their funds' \$1.00 NAVs.

### Will a sponsor's decision to delay payment on redemptions, redeem in kind, or freeze subscriptions and redemptions negatively affect the rating on the fund?

No. Our PSFRs address a fund's capacity to maintain principal stability and limit exposure to principal losses due to credit, market, and/or liquidity risks. They do not address the timing of

payment. Under our criteria, a fund manager's decision to make payments in kind or to suspend redemptions does not in and of itself affect the PSFR, unless it coincides with negative principal effects.

**When a rated money market fund's investment is downgraded below the level required for a 'AAAm' rating, does Standard & Poor's automatically place the fund on CreditWatch or downgrade the fund if the fund manager does not sell the affected security?**

No. We may refrain from placing a fund on CreditWatch or downgrading it as the result of a downgrade on one of the fund's investments if the investment remains "investment grade," the fund's exposure to the investment represents a small proportion of the entire portfolio, the fund's asset base is stable, the investment has a short maturity, and/or the fund's sponsor takes action to support the fund.

**Why didn't Standard & Poor's take rating actions on some funds that held Lehman debt?**

We assess each fund based on its overall exposures and its ability to maintain principal stability. Our PSFRs are based in part on management and its range of potential actions. Accordingly, we first discuss actions that the management team is considering given the current circumstances to understand how the action may affect our view of the fund's NAV and our assessment of the rating level. We generally will not take an immediate rating action if management intends to take supportive actions to preserve the fund's NAV in a timely manner, and presents us with a credible plan to do so. In the past week, several managers, sponsors, or the parents of fund sponsors of rated funds swiftly implemented support agreements or purchased defaulted securities from their funds to maintain stable NAVs. Given these supportive actions, we did not take rating actions on these funds.

**What happens if a fund manager requests the withdrawal of Standard & Poor's rating to avoid a negative rating action?**

Upon receiving a written request to withdraw the fund's rating, we analyze the portfolio as of that date and determine the appropriate rating level of the fund. If that rating differs from the existing rating, we change the rating and publish the revised ratings, consistent with our standard ratings dissemination procedures, along with a brief description of the fund. The rating is then withdrawn, noting that the withdrawal was at the request of the fund manager.

**How large is the money market fund industry in the U.S. and Europe?**

The September 2008 issue of Money Market Insight (produced by iMoneyNet, an Informa Financial company) reported total assets of the 1,857 U.S. money market funds at \$3.48 trillion. At that time there were reported to be 1,305 taxable funds comprising \$2.96 trillion or 85% of all assets and 552 tax-free funds comprising \$0.5 trillion. The September 2008 issue of Money Fund Intelligence™ published by Crane Data LLC reported assets of Institutional Prime money market funds (First Tier or CP funds) were \$1.14 trillion and assets of Retail Prime money market funds were \$840 billion.

According to the latest available figures from the European Fund and Asset Management Association, at the end of June 2008, reported total assets for UCITS (UCITS refers to funds complying with the European Directives on Undertakings for Collective Investments in Transferable Securities) money market funds amounted to €1.02 trillion. European and offshore domiciled 'AAAm' rated money market funds represented €388 billion or about 38% of the European UCITS money market fund assets at the end of June 2008.

**How can money market funds be exposed to subprime mortgages?**

Although funds may not have direct ownership, indirectly they may be exposed via investments made in ABCP programs or collateralized debt obligations, or in institutions that are exposed to subprime-related investments (e.g., commercial paper issued by banks).

**What is Rule 2a-7?**

Rule 2a-7 under the Investment Company Act of 1940 governs U.S.-registered money market funds. The rule outlines specific investment and operating guidelines for registered money market

funds, including maximum WAM of 90 days or less, 397-day maximum final maturity of a fixed-rated security, at least 95% invested in first-tier securities (i.e., 'A-1', 'P-1', 'F-1', etc.), no more than 5% in second-tier securities (i.e., 'A-2', 'P-2', 'F-2', etc.), detailed diversification guidelines, and mandates certain reporting requirements to shareholders and the SEC.

### Has any other U.S. money market fund ever broken the buck?

Since the inception of money market funds in the early 1970s, prior to last week, there had only been one instance in which a U.S.-registered money market fund paid out less than \$1.00 per share NAV. In 1994 Community Asset Bank, an institutional money fund that we did not rate paid out \$0.96 a share. Over the years, there have been more than 50 SEC-registered money market funds in which sponsors took preemptive measures to maintain their funds' \$1.00 NAVs.

### Are money market funds required to provide daily liquidity?

No. Historically, money market funds have provided investors with daily access to their money. However, a typical U.S. money market fund reserves the right to send proceeds within seven days after the fund receives a redemption request and to provide those redemptions in-kind.

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