Investment GUIDE with Eric Tyson

Questions & Answers for Financial Success

Insurance on Money Market Funds?

Question

Do money market mutual funds carry insurance or not? My fund company told me last year that they do carry insurance, but my local bank tells me that's not true.

Answer

Well, believe or not, both companies may be telling you the truth!

First, a little recent history. During the height of the financial crisis in 2008, in early September of that year, the share price of a money market fund – the Reserve Primary Fund – fell below $1 per share, the normally fixed price for all money funds. This fund actually declined three percent to $0.97 per share. While three percent is a small decline, especially compared with declines in the stock market, investors in money market mutual funds have enjoyed and came to expect that the share price of their money funds would hold constant at $1 per share. (Reserve lost some money on Lehman commercial paper that it owned, which plunged in value when Lehman filed for bankruptcy.)

To calm nervous investors, then-U.S. Treasury Secretary Henry Paulson announced a new insurance plan that would cover money market fund asset balances that investors had in money funds on September 19, 2008. A specific date was chosen, as regulators didn't want investors, especially large institutional investors, continuing to move money around trying to game the system. Some banks also complained that with insurance coverage instituted on money funds, bank depositors might move money from banks to the higher-yielding money market funds – if banks and money

funds both had insurance, why leave your money in a lower-yielding bank account?

The new money market fund insurance program was not intended as a long-term or permanent change for the money market mutual fund business. The insurance ended on September 18, 2009, one year after its inception.

Historically, since their inception in 1972, money market funds have been extremely safe. Only one other fund broke the buck (by six percent) and that was a fund run by and invested in by only a modest number of institutional investors. Today, assets in all money funds (both retail and institutional) total more than $3 trillion. Hundreds of trillions of dollars have flowed through money funds over the decades, without any retail investors losing principal.

Rather than boosting yield by keeping their expenses low, some money funds venture into riskier debt to boost their fund's yields. That's one of several reasons why I recommend that when you invest in money market funds, you do so with a larger and conservatively managed investment company that keeps expenses low, which is the only safe way to boost a money fund's yield. These firms don't generally stretch for a little extra yield by taking silly risks, and in the highly unlikely event that they ever bought something problematic, they would surely make good on the $1 per share price.

In the late 2000s, a couple dozen money fund owners began infusing modest amounts of capital into their money funds to keep them from possibly breaking the buck when they held a security that may have had to be listed at a reduced value on the fund's books. Taking such action requires U.S. Securities & Exchange Commission approval. Such requests have happened before, but their pace increased dramatically during the 2008 financial crisis. Fund companies having to take such action included Allianz, HSBC Holdings, Legg Mason, Northern Trust, Ridgewood Investments, SEI Investments, TD Ameritrade, and Wells Fargo.

According to law professor and industry observer Mercer Bullard, the law is unclear as to whether fund companies ever need to disclose to their shareholders that they sought relief for their money funds and were blessed to do so by the SEC. **N**

*Eric Tyson is a best-selling author (*Personal Finance for Dummies, Investing for Dummies, Mutual Funds for Dummies, Home Buying for Dummies*). He is read by more than four million people nationwide. A management consultant to Fortune 500 financial service firms, he also founded a counseling firm providing financial advice to non-wealthy investors, teaching that "one must live within one's means as a prerequisite to building wealth."*