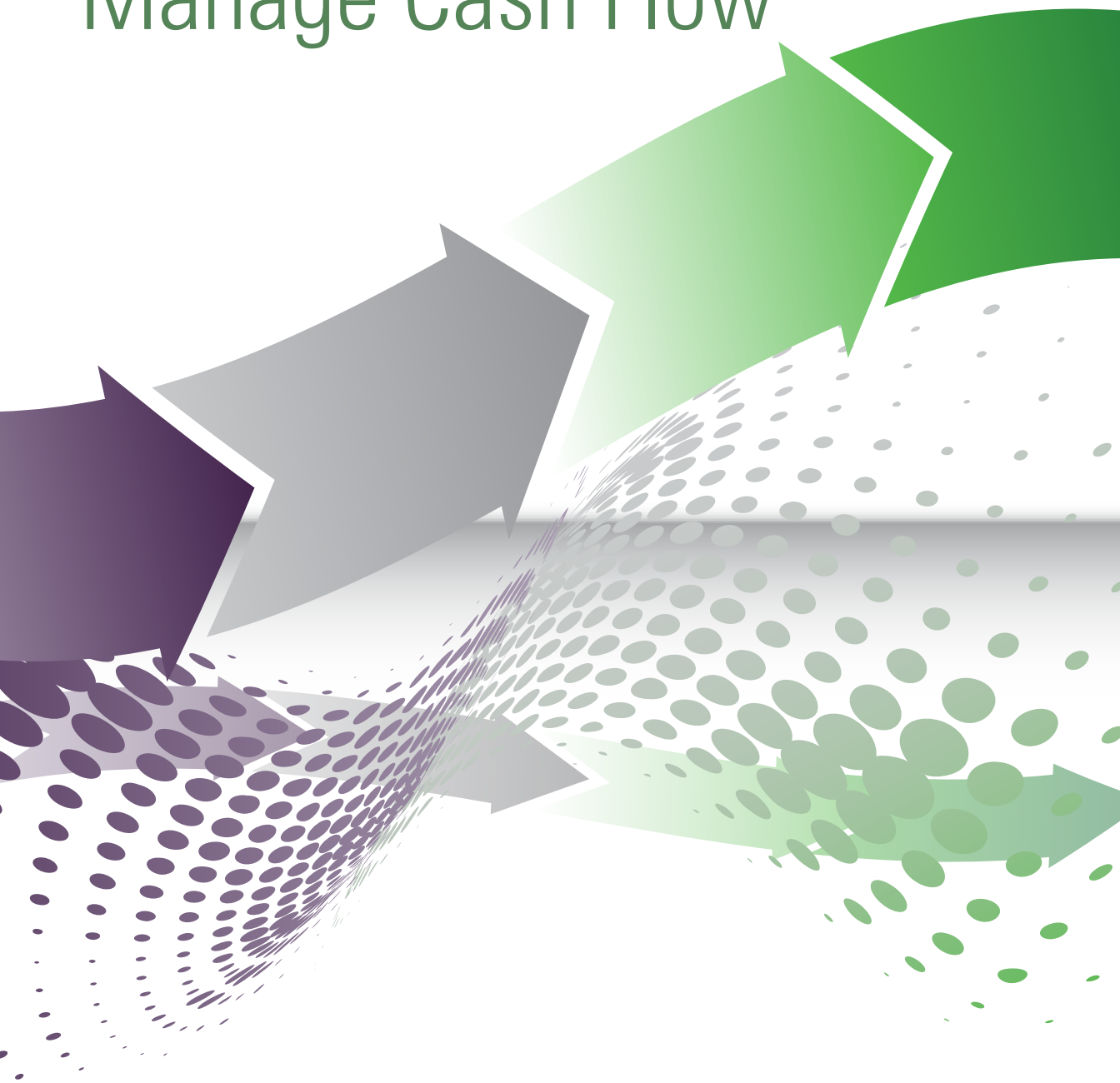
Money Market Funds

Helping Businesses Manage Cash Flow



Center for Capital Markets Competitiveness®

CENTER FOR CAPITAL MARKETS
COMPETITIVENESS®

Since its inception, the U.S. Chamber's Center for Capital Markets Competitiveness (CCMC) has led a bipartisan effort to modernize and strengthen the outdated regulatory systems that have governed our capital markets. Ensuring an effective and robust capital formation system is essential to every business, from the smallest startup to the largest enterprise.

Money Market Funds
How They Help Businesses Manage Cash Flow

Money market funds play a critical role in meeting the short-term capital needs of American businesses. For many businesses, cash inflows and outflows don't always line up, and money market funds act as a financial intermediary in helping businesses offset these discrepancies. When companies have a temporary cash shortfall, they often turn to short-term financing instruments, such as commercial paper to bridge the gap. Money market funds provide much of the necessary capital to fund the commercial paper market. When companies have cash in excess of immediate needs, they invest it in money market funds.

For example, retail stores preparing for the holidays must purchase inventory months in advance. Since the sale of the merchandise may not occur until sometime later, money market funds invest in or finance the short-term instruments that companies issue to cover the cost of the inventory. Conversely, after the holiday season, companies' revenues surpass their current expenses. Rather than sidelining the surplus cash, they invest it in money market funds until the next bills are due.

The dual roles that money market funds play in helping businesses manage their cash flow make it an important tool for corporate treasurers. Businesses invest in money market funds because they are safe, liquid investments that historically provide a reasonable rate of return. Money market funds invest in U.S. Treasuries, municipal bonds, corporate commercial paper, and other short-term securities, which are liquid and low risk. Businesses' financing is also supported by money market funds through the funds' investment in corporate commercial paper. Money market funds are major investors, purchasing one-third of all commercial paper issued. Businesses prefer commercial paper to bank loans for short-term financing because of the ease and efficiency in issuing commercial paper as well as the lower interest rate.

Money market funds play a critical role in meeting the short-term capital needs of American businesses.

It is a win-win investment for investors and businesses. No wonder this safe and convenient financial product is so popular.

But now regulators want to change how money market funds work. These changes are unnecessary and would fundamentally alter the effectiveness and efficiency of money market funds, ultimately driving up operational costs for businesses and restricting capital.

Tell regulators not to mess with money market funds. They work.

What Is a Money Market Fund

A money market fund is a mutual fund that invests in the "money market." In other words, it deals in the market for money—such as U.S. Treasuries, government obligations, repurchase agreements, commercial paper, and bank certificates of deposit. Because the average maturity for these investments is short term—60 days or less—and because they are very high quality, the investment risk is small. By investing only in a diversified, high-quality portfolio of short-term assets, money market funds are able to provide liquidity and attractive rates to investors.

Money market funds enable businesses to efficiently and affordably manage cash that can be invested and withdrawn on a daily basis because of the stable $1.00 share price. This feature makes them a leading investment for excess cash along with their convenience, simplicity, and reasonable rate of return.

Companies Rely on Money Market Funds to ...

Pay Seasonal Employees: Farmers

Farmers receive most of their income once their crops are harvested and sold. However, they need a strong labor force to tend the fields year-round. In order to pay their employees during the non-harvesting seasons, many farmers rely on short-term financing until their crops are sold. Farm Credit Banks and Farm Cooperatives use commercial paper to support their farmers' needs.

Who Uses Money Market Funds

EVERYONE! Money market funds provide a safe, convenient, liquid investment vehicle for Main Street businesses, individuals, state and local governments, and other organizations to invest cash until it is needed. Money market funds also invest in the short-term financing instruments of an array of borrowers. Short-term, low-cost financing lets companies meet working capital needs; allows banks to finance credit cards, home equity, and auto loans; and helps local governments build roads, bridges, schools, and hospitals.

Main Street Businesses: Because companies can have cash fluctuations in the millions of dollars each day, money market funds provide the liquidity necessary for these companies to earn dividends on excess cash while being able to withdraw funds quickly to pay expenses. Money market funds are also major buyers of corporate commercial paper, a flexible short-term financing mechanism for large businesses to get the necessary funding for their working capital needs on a timely basis.

Individuals: Retail investors use money markets funds and benefit from the historically higher yields than the average checking and saving accounts afford them. Like businesses, individuals enjoy the convenience and liquidity of money market funds to invest excess cash. For example, a home buyer who has liquidated investments in anticipation of closing on a new home, or an investor who sells stocks in his

portfolio, can use money market funds to earn dividends until the cash is deployed elsewhere.

State and Local Governments: State and local governments use money market funds because they experience cash fluctuations due to the timing of tax receipts. Municipalities invest excess cash in money market funds, while municipal bonds are sold to these funds. The financing pays for local and state projects, including building schools, repairing roads and bridges, creating jobs, and spurring local economic activity.

Other Organizations: Universities, endowments, charities, port authorities, and nonprofit organizations use money market funds as a safe, liquid, and affordable cash management tool.

How Main Street Businesses Use Money Market Funds

For many businesses, money market funds are the preferred way to manage fluctuations in cash and to ensure adequate cash flow when needed. Businesses across the country benefit from money market funds in two ways—as an investment tool to invest working capital and as a market for the short-term instruments they issue to finance short-term funding needs. They are a critical cash management tool for Main Street businesses, and it is crucial to ensure that businesses continue to have access to convenient, low-cost, short-term financing and investment options.

Short-Term Investing

Money market funds provide a safe, convenient, liquid investment vehicle to park the cash until it is needed. As an investment tool, businesses prefer money market funds as they historically provide a higher yield than bank accounts. And while corporate treasurers know that money market funds are not risk-free investments, the stable net asset value (NAV) feature of the product seeks to ensure that if they put $20 million in, they will get $20 million out. In addition, the stable NAV makes money market funds attractive because of the simplicity in accounting for transactions and taxes.

Short-Term Financing

Short-term financing provides companies with cash to purchase seasonal inventory, pay suppliers, and fund payroll and other expenses when cash outflows are greater than inflows. Many companies issue commercial paper, which is a form of short-term borrowing. Money market funds purchase approximately one-third of all commercial paper, making them one of the largest sources of short-term financing for corporations.

More than 1,700 companies rely on commercial paper. Commercial paper is a short-term line of credit (usually less than one year) issued by the highest credit quality firms. Companies prefer to issue commercial paper, rather than secure bank loans because of its flexibility, efficiency, and low cost. Commercial paper's maturity dates are as short as 30 days and as long as 9 months. Moreover, commercial paper can be issued in a matter of hours, instead of the week's notice that is required by banks to get a bank loan. Perhaps the most attractive feature of

commercial paper is its favorable interest rates, saving companies significant expenses that can be used for expansion. Commercial paper is a critical component of the U.S. economy, providing approximately $1 trillion in short-term financing in 2011.

If money market funds are no longer a viable buyer of short-term financing instruments, businesses would be forced to take on longer-term debt, thereby increasing their funding costs, slowing their expansion rate, and reducing job growth and economic recovery.

Businesses across the country benefit from money market funds in two ways—as an investment tool to invest working capital and as a market for the short-term instruments they issue to finance short-term funding needs.

Money Market Funds …

- Purchase more than one-third of all short-term commercial paper issued by companies.
- Hold more than half of the state and local government short-term debt that pays for necessary projects such as roads, bridges, schools, and hospitals.
- Buy more than 10% of short-term paper issued by the U.S. Treasury, enabling the U.S. government to stay open.

The History of Money Market Fund Regulation

The first money market fund was started in 1971. It was established much like a mutual fund, investing money on behalf of investors, with an investment policy designed to keep the share price at $1.00. As inflation hit and interest rates shot up in the 1970s, money market funds became a more attractive investment vehicle.

In the 40-year fund history, only two funds have not maintained the stable $1.00 per share price day in and day out. In 2008, during the height of the financial crisis and the demise of Lehman Brothers, the Reserve Fund that held Lehman's commercial paper "broke-the-buck," meaning that the share price dipped below $1.00 to $.97. This, coupled with historic events in the financial system that rattled market confidence, led to investors pulling cash out of money market funds. Ultimately, the federal government implemented a temporary guarantee program for money market funds to even the playing field—for the first time ever.

Following the financial crisis of 2008, the U.S. Securities and Exchange Commission (SEC) adopted new safeguards for money market funds, further regulating the quality, maturity, liquidity, and diversification of assets. These enhancements are working. Today, money market funds are well positioned to endure financial market stresses, including the recent domestic debt-ceiling crisis and the European sovereign debt crisis.

Today, money market funds are well positioned to endure financial market stresses, including the recent domestic debt-ceiling crisis and the European sovereign debt crisis.

However, in October 2010, the President's Working Group on Financial Markets issued a report saying that money market funds are susceptible to runs and provided several options for additional regulation. These options include floating the net asset value that would force funds to abandon the stable $1.00 price per share. Federal regulators are also focusing on other bank-like requirements for the funds. These well-meaning, but extreme, proposals would have the unintended consequence of destroying the money market fund industry.

Companies Rely on Money Market Funds to ...

Buy Inventory: Retail Stores and the Holiday Season

Department stores purchase extra inventory in advance of the holiday season. Because the bulk of sales take place leading up to the holidays, department stores need to borrow cash up front to purchase special inventory.

2010 Money Market Fund Reforms

Following the 2008 crisis, the SEC implemented in early 2010 new safeguards for money market funds through enhancements to Rule 2a-7. These new regulations set stricter parameters in which money market funds operate.

Invest in only high-quality investments

Money market funds must invest 97% of their assets in tier-one (A1/P1) grade investments or government securities.

Keep assets liquid

30% of money market funds' assets must be accessible within a week.

Shorten maturity of portfolio investments

The maximum dollar weighted average maturity of a money market fund's portfolio was reduced from 90 days to 60 days.

Increase transparency

Money market funds are required to disclose portfolio holdings every month on their website.

These enhancements have strengthened the resiliency of money market funds and have positioned them to endure financial market stresses.

Companies Rely on Money Market Funds to ...

Invest Cash Until Bills Are Due: Construction Companies

Construction companies generally receive deposits before their suppliers and subcontractors need to be paid. This time lag between payments enables companies to invest the cash in money market funds. By investing the cash deposits, companies can keep the money active and make a modest yield.

Unintended Consequences of Additional Reforms

Businesses Lose a Significant Source of Funding: Since money market funds purchase one-third of all corporate commercial paper, a shrinking money market fund industry would reduce the market for this vital type of financing. While larger businesses will almost always secure bank financing because of their sheer size and creditworthiness, smaller companies that need capital the most will struggle to compete for bank financing. In addition, bank lending does not have the capacity to replace the entire void that would be left by a defunct $1.1 trillion commercial paper market.

Businesses Face Higher Financing Costs: With lower investor demand for corporate commercial paper, businesses will be forced to seek financing from banks or other lenders and face higher fees and interest rates. These additional costs will place more pressure on businesses to cut expenses elsewhere, including infrastructure and hiring. Such cuts will inevitably lead to a ripple effect in the American economy, endangering the already fragile economic recovery.

Corporate Money Moves Out of Money Market Funds: Given the complexity of accounting for a floating NAV and the cost of modifying existing systems to support it, corporations will flee money market funds if they no longer provide a stable NAV. Moreover,

some companies have existing investment policies that prohibit the investment of cash in instruments without a stable NAV.

Capital Flees the United States and Moves to Unregulated Markets: If the money market fund industry shrinks, the $2.5 trillion in funds may end up in offshore investment vehicles or other unregulated investment products.

Encouraging investors to migrate to less regulated investment vehicles is not, however, consistent with efforts to reduce risk, increase market transparency, and ensure greater market stability. Forcing investors into narrower bands of financial products and institutions will only increase risk and weaken the stability of the financial markets.

Companies Rely on Money Market Funds to ...

Invest Working Capital: Grocery Stores

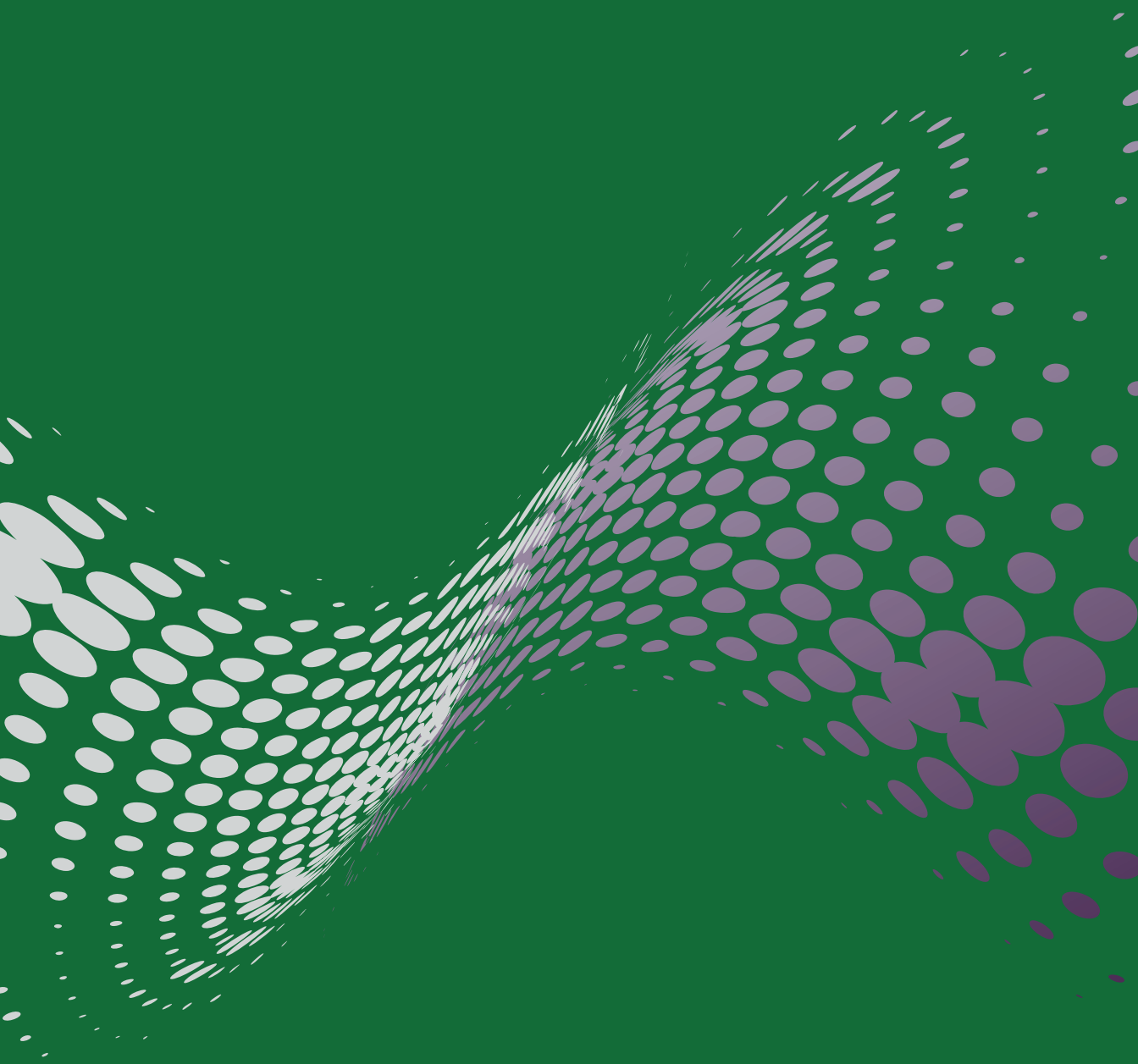
Grocery stores generate most of their revenue over the weekend when consumers do major shopping. By Monday morning, stores are flush with cash, but payables aren't generally due until week's end. Excess cash is invested in money market funds until the company must meet payroll, purchase additional inventory, or pay suppliers.

The U.S. Chamber of Commerce's Position

While the U.S. Chamber supports preserving and strengthening money market funds as a critical source of business financing and investment, it believes that the SEC's January 2010 enhancements that set stricter parameters in which money market funds operate are working. Over the past year, while the financial markets have been tested, money market funds have proven to be resilient, safe, and strong.

Additional reforms are unnecessary and would fundamentally alter the effectiveness and efficiency of money market funds, making them a less useful source of investing and financing for everyone—Main Street businesses, state and local governments, and other organizations.

Additional reforms are unnecessary and would fundamentally alter the effectiveness and efficiency of money market funds, making them a less useful source of investing and financing for everyone—Main Street businesses, state and local governments, and other organizations.



CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

U.S. Chamber of Commerce
Center for Capital Markets Competitiveness
1615 H Street, NW
Washington, DC 20062
www.centerforcapitalmarkets.com