Ten Years After: Reserve Fund “Breaks the Buck”

It was ten years ago this month that the bankruptcy of Lehman Brothers caused Reserve Primary Fund, the first and one of the largest money funds, to "break the buck," or drop below $1.00 per share. The event, following a year of subprime mortgage related tremors and runs on segments of the asset-backed and enhanced cash markets, triggered a full-scale financial meltdown. The week of Sept. 15, 2008, started with the Lehman Brothers bankruptcy, and ended with President George W. Bush stepping in to guarantee money funds and the broader banking system in its entirety. Below, we excerpt from some of our News during that fateful month, and we look back at the events that shook the money fund world.

On Wed., Sept. 17, 2008, we wrote the story, “Reserve Primary Fund ‘Breaks the Buck’ Following Run on Assets.” It says, “In just the second case of a money market mutual fund ‘breaking the buck,’ or dropping below the $1.00 a share level, in history, The Reserve Primary Fund cuts its NAV to below the $1.00 a share level, in history, [Click to read more] (Continued on page 2)

New IMMFA Chair Hochfeld on European MMF Reforms

This month, Money Fund Intelligence speaks with Kim Hochfeld, the new Chair of IMMFA, the London-based Institutional Money Market Funds Association (www.immfa.org). Hochfeld, who is also Managing Director at Morgan Stanley Investment Management, gives us the latest on European Money Market Fund Reforms and talks about what’s next for money funds in Europe. Our Q&A follows. (Note: Hochfeld and IMMFA MD Jane Lowe will keynote our upcoming European Money Fund Symposium in London, Sept. 20-21.)

MFJ: When did you become Chair? Hochfeld: I was elected Chair for a three year term at the beginning of July by members at our Annual General Meeting. Our former Chair, Reyer Kooy, was re-elected to the Board, which is positive for IMMFA as it allows a level of continuity. Kathleen Hughes from GSAM and Ian Lloyd from LGIM are still on the Board too, and we have been joined by (Continued on page 3)

DWS Launches ESG Liquidity, Socially Responsible MMF

As we mentioned in our August 13 News, “DWS Converts Variable NAV to DWS ESG Money Fund, First ESG Offering,” the manager formerly known as Deutsche just converted an existing fund into an “ESG” money market fund. A Sept. 7 press release, entitled, “DWS launches first ESG money market fund in the U.S.,” tells us “DWS Group today announced the launch of DWS ESG Liquidity Fund (ESGX), the first money market fund available in the U.S. to apply ESG (Environmental, Social and Governance) criteria. The fund will invest in high-quality, short-term, U.S. dollar-denominated money market instruments paying a fixed, variable or floating interest rate while also filtering for various ESG factors using DWS’s proprietary software — the ESG Engine.”

Sonelius Kendrick-Smith, Head of Liq uidity Solutions, Americas, comments, “As a global asset manager, it is crucial for DWS to enable our clients to invest in a sustainable future by incorporating ESG factors into their global investment pro- (Continued on page 6)
$0.97 cents on Tuesday. The top-ranked fund, which held $785 million in Lehman Brothers CP and MTNs, was besieged by redemptions over the past two days. Assets of the total portfolio, which is largely institutional but which includes some retail assets, declined a massive $27.3 billion Monday and Tuesday to $35.3 billion."

Our update continued, "Reserve said in a statement late yesterday, 'The Board of Trustees of The Reserve Fund, after reviewing the unprecedented market events of the past several days and their impact on The Primary Fund, a series of The Reserve Fund and taking into account recommendations made by Reserve Management Company, Inc., the investment manager of The Primary Fund, approved the following actions with respect to The Primary Fund only: The value of the debt securities issued by Lehman Brothers Holdings, Inc. (face value $785 million) and held by the Primary Fund has been valued at zero ... as a result, the NAV of the Primary Fund, effective as of 4:00PM, is $0.97 per share."

The piece adds, "As we wrote Monday, several other firms have protected their investors from fallout from the Lehman Brothers bankruptcy.... A total of 21 money funds to date have taken action to protect shareholders, but the privately-held Reserve was unable to arrange credit supports in time to prevent a run.... The combination of high yields, hot money and a lack of deep pockets likely will prove fatal to the first, and oldest money market mutual fund. As happened in 1994 with the liquidation of Community Bankers U.S. Government Money Market Fund at $0.96 a share [the only other money fund to ever 'break the buck'], we expect money market funds to soldier on with just a single case of a fund 'breaking the buck.'"

On Sept. 16, 2008, Crane Data wrote, "Lehman Support Actions Push Money Fund Bailouts to 20 Total." This update explained, "We wrote yesterday about money funds' limited exposure to Lehman Brothers and about the support actions taken by investment advisors so far. Evergreen and Russell have disclosed..."
Beccy Milchem from BlackRock. So it’s a team with plenty of experience.

**MFI: What’s been IMMFA’s main focus?**

Hochfeld: European Money Market Reform has absolutely been a key focus for us, especially over the last 18 months. It has been a long time coming. We have been focused on defining our LVNAV structure and working with clients to make sure they understand how LVNAV works, and then obviously there are challenges for our members as to how they position their Euro funds. There’s still much work to do, by the vendors, the money fund managers, the transfer agents, the fund administrators, the portal providers, their trading systems, etc., in order to be ready for the coming changes.

One of the challenges is the clarity around Euro MMFs. For example, there is still an element of uncertainty as to whether share cancellation as a mechanism for handling negative yield will be permitted under new Regulations. This is the so-called RDM [reverse distribution mechanism]. It seems that most providers have built for different outcomes, although the market has different viewpoints as to which scenario will prevail.

**MFI: What happens after reforms?**

Hochfeld: I think where IMMFA can really add value is around education and marketing, particularly if RDM does not continue ... and managers have to make choices about what they will offer in stead. IMMFA’s expectation is that over time the membership will offer most types of short-term money funds, both VNAV and CNAV.

It will therefore be important to educate our existing and any prospective investors about the difference in running short-term VNAV Euro funds vs. how some of the existing short-term Euro VNAV funds are managed. There will be big differences in the old IMMFA-style universe of short-term money funds that are all AAA-rated, compared to some of the VNAV funds that are out there at the moment, which generally don’t have a rating and have a lot more flexibility to take more risk to generate a higher return.

Over the next year, the IMMFA will be focused on broadening our investor base globally and tackling challenges related to accounting treatment; to see if we can achieve more consistency and certainty on the accounting treatment of short-term money funds in the European Regulation, much as the S.E.C. offered for U.S. 2a-7 money funds.

**MFI: Does IMMFA only deal with short-term money market funds?**

Hochfeld: Not any more. Historically IMMFA only represented CNAV short-term money funds. Yes, we had accumulating share classes, but they still use amortized cost accounting. However the Association always viewed the European Regulation as a game changer, because it codified the regime for money funds across the whole of the European Union. So IMMFA responded to it by changing its constitution effective 1 January 2018 to cover all types of money market fund permitted under the Regulation. It means that now we cover CNAV and VNAV short term MMFs, and also VNAV standard MMFs. To put it in context, the VNAV standard MMFs in Europe are essentially the same product as U.S. ultra-short bond funds.

Also, once the Regulation came into force, the need for the IMMFA Code of Practice diminished, as much of what is in the Code now appears in the Regulation. The Code still applies to members, but from January 2019 it will be replaced entirely by the IMMFA Principles of Best Practice. Details are available on the IMMFA website. All IMMFA members are bound by the Principles of Best Practice. In replacing the Code, IMMFA sets out what the Principles would do instead.

To quote: “The Principles have two purposes, both of which are intended to support investor confidence in the industry: To describe in plain English the key requirements that apply to money market funds and that operate to protect investors and markets; and to describe additional practices beyond the applicable regulatory requirements where these are considered necessary for the good governance of the funds.”

(Money Fund News cont. from page 1)

to one sector: money-market funds. Their expense ratios remain far higher than the rock-bottom costs of index funds, since there seems to be little competition to induce issuers to provide higher yields (although Interactive Brokers Group [IBKR] touts the rates it pays on customers’ cash balances). Nobody cared about money-fund yields when the Fed was pinning short-term interest rates near zero in the wake of the financial crisis (and when fund companies had to absorb these funds’ expenses in order to keep their yields at zero or slightly positive). But now that the central bank has lifted its fed-funds target range to 1.75%-2%, money markets are competitive with the 1.8% dividend yield on the S&P 500.

**SEC Money Fund Statistics:** Prime Assets Break $700B; Yields Up Again. The Securities & Exchange Commission’s latest “Money Market Fund Statistics” summary shows that total money fund assets rose by $15.2 billion in July to $3.114 trillion. Prime MMFs showed a big jump, breaking above the $700 billion level for the first time since Sept. 2016, but Govt and Tax Exempt funds declined. Gross yields rose for Prime and Government Funds in the latest month, but plunged for Tax Exempts. Of the $3.114 trillion in assets, $701.4 billion was in Prime funds, which increased by $24.3 billion in July. Prime funds represented 22.5% of total assets at the end of July. They’ve increased by $76.5 billion, or 12.2%, over the past 12 months. Government & Treasury funds totaled $2.278 trillion, or 73.2% of assets. Yields on Taxable MMFs moved higher again. The Weighted Average Gross 7-Day Yield for Prime Funds on July 31 was 2.18%, up 2 bps from June. Gross Yield
(New IMMFA Chair Hochfeld from p. 3)

**MFI:** Accumulating funds are different than VNAV, right?

Hochfeld: They’re very different. Today’s accumulating share classes are share classes whereby the accrued interest is rolled up into the NAV every day. The capital portion, the part which would otherwise be 1.00 in a CNAV share class, does not change in an accumulating share class. That is stable, because accumulating share classes today still use amortized cost accounting to value the underlying assets. So, the change in the price is merely reflective of the accrued income. For a VNAV fund, the change in the price is reflective of both the accrued income and the mark-to-market on the underlying assets.

**MFI:** What are some of the main differences with U.S. reforms?

Hochfeld: There are aspects of European reforms which are more complex than the U.S. 2a-7 reforms, although the new product types are arguably better aligned to existing funds. The LVNAV product is a new fund type, so the market is having to come to grips with its complexities. It is much easier to understand the public debt CNAV product, as this is ... like today’s government funds.

Another difference is that we do not have trigger-based fees and gates on our VNAV funds but we do have them on our treasury fund equivalent. For VNAV, we still have the provision for fees and gates at board discretion under UCITS rules, which is what we have at the moment on our existing CNAV funds.

**MFI:** Can you talk about investors?

Hochfeld: I speak to investors all the time, and from a relative value perspective our euro funds still offer great value to clients that are holding cash in euros. From a risk-return perspective, the funds still represent the gold standard.

There is a wide variety of different investors types in our European funds, including corporations and financial institutions, and it is specific to different currencies. [For example], local authorities in the U.K. are able to use money funds, as are pension funds in the Netherlands. It’s not that money funds are more attractive to one market or another, it’s that they’re more attractive to one investor type specific to one market or another.... A big chunk of investment also comes from financial institutions, whether they’re funds or third-party, sweep money or insurers. [Recent IMMFA statistics show corporates, funds, third parties, financials, insurers, and the public sector as the largest investor segments.]

I’d say a major theme that the industry is working on through IMMFA, as well as on a fund by fund basis, is getting money funds accepted as collateral at clearing houses. Money market funds do qualify for holding client monies in Europe, but it has to be implemented on a country by country basis (because of the link into insolvency law). So at the moment we have mostly focused on the U.K. Getting a wider acceptance of the use of money funds for that cash would be a great boon in assets for the industry.

**MFI:** Is there fee pressure? What about MMF competitors?

Hochfeld: Fee pressures come from within the industry and from competing products.... In terms of our competitors, bank deposits are clearly a big competitor, but it’s not just depo. It’s repo, ultra-short or short duration strategies, whether those are pooled funds or separately managed accounts. Structured deposits are also competing for short term cash, as are other funds, for example, that invest in supply-chain receivables. There are a lot of options out there.

**MFI:** What’s your outlook overall?

Hochfeld: I’m optimistic about the future. These reforms will bring substantial change to our industry and we will work with investors to ensure they understand the implications. But longer-term, we think they’re a real positive for money funds. They’re designed to make the product more robust and more transparent, and that in turn should incentivize cash rich investors to use money funds to manage excess liquidity rather than using a bank account or a repo.

We think that along with new markets and new technology platforms that are being developed, money funds are going to become more attractive and more proliﬁc for cash investors. I don’t think that Basel III and bank appetite for short-dated deposits are going to go away any time soon. So along with a more attractive yield environment in dollars and sterling, and hopefully euro in the not too distant future, IMMFA and its member firms firmly believe that money funds remain an attractive yield and risk diversiﬁcation play for short-term cash investors.

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**Money Fund News** cont. from page 3

Yields increased to 1.96% for Government/Treasury funds, up 0.02% from the previous month. **Tax Exempt Weighted Average Gross Yields fell 43 bps in July to 1.10%**. The Weighted Average Net Prime Yield was 2.00%, up 0.02%.

- Crane Data’s August Money Fund Portfolio Holdings Show Jumps in Treasuries, CP & CDs. Our July 31, 2018 numbers show increases across all com-

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**Certificates of Deposits (CDs)** rose by $12.0 billion (7.1%) to $181.4 billion, or 6.1% of taxable assets. Other holdings, primarily Time Deposits, rose by $4.1 billion (5.1%) to $83.3 billion, or 2.8% of holdings. VRDNs were relatively flat, falling $0.08 (0.4%) to $8.3 billion, or 0.3% of assets. (Watch for our next Portfolio Holdings update Wednesday.)

- Dillon Eustace Published “MMF Regulations Update August 2018,” which says, “On 10 April 2018 the European..." (Continued on page 6)
support agreement for their funds, while some other funds have disclosed Lehman holdings and pledged to maintain their $1.00 NAVs. The vast majority of money funds appear to have no direct exposure to Lehman, though they’re now answering questions on AIG ... and WaMu.”

The news continued, “The latest crisis should bring Crane Data’s tally of the number of advisors supporting their money funds over the past 13 months to 20. Besides Evergreen, money funds disclosing or showing holdings of Lehman in recent public filings include: Columbia Cash Reserves, which held $400 million, or 0.73% of its assets; Reserve Primary; and Russell Money Market Fund. All are expected to protect their funds from any threat to the $1.00 a share NAV.”

It added, “Last night, Dow Jones covered the story in, ‘Wachovia To Bolster Evergreen Funds, More Support To Come.’ It quotes Peter Crane, ‘I would expect you’re going to see at least a couple of more support actions where the advisor seeks protections and purchases the Lehman or AIG (American International Group) or Washington Mutual (WM) paper from the fund.’”

See also our Sept. 21, 2008 News, “Week in Review: Lehman, Buck Breaks, Run Develops, Treasury Bailout.” It said, “What a week! Last Sunday night’s bankruptcy of Lehman Brothers triggered concerns about money fund exposure and questions over The Reserve Funds’ ability to protect downgraded CP and MTN holdings in its Primary Fund. While all of the five other fund advisors with Lehman protected their holdings, Reserve’s too little, too late support statement failed to slow a run on the fund. On Tuesday, this triggered just the second ‘breaking of the buck’ since Reserve Primary, the first money fund ever, was launched in 1971.... Events quickly became dire as Putnam Prime Money Market Institutional halted redemptions, and as outflows grew to almost $200 billion, or almost 7% of MMF assets.”

Our 9/21/08 News continued, “Friday the U.S. Treasury stopped the run with the announcement of a plan that would insure money market funds’ $1.00 NAVs. President Bush said money market mutual funds are a ‘key element of America’s financial system,’ and added, ‘For every dollar invested in an insured fund, you will be able to take a dollar out.’”

For more on the Subprime Liquidity Crisis (or Global Financial Crisis), see Crane Data’s Sept. 2008 News Archives, J.P. Morgan’s new piece, “Money markets: The forgotten epicenter of the global financial crisis,” and the WSJ’s “The Financial Crisis: 10 Years Later.”

A Brief Recent History of Money Market Fund Bailouts & Buck-Breakings

1994 Orange County Bankruptcy, Muni MMF Bailouts, Community Bankers MMF.
1996 General American Life FA Defaults.
1997 Strong MMFs, Mercury Finance CP.
2001 PG&E & SCE Default & Bailouts.
2007 Extendible ACP Issues, Columbia Strat Cash Freezes, Subprime Turmoil.
2008 SIV CP Bailouts, Reserve Primary Fund Breaks the Buck.
**Brokerage Sweep Rates (8/31/18)**

<table>
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<tr>
<th>Brokerage</th>
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<th>Rate</th>
<th>Money Fund</th>
<th>Yield</th>
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<tr>
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<td>0.14%</td>
<td>GGDXX</td>
<td>1.41%</td>
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<tr>
<td>E*Trade</td>
<td>Bank</td>
<td>0.15%</td>
<td>JUSXX</td>
<td>1.02%</td>
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<td>Fidelity</td>
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<td>0.53%</td>
<td>SPAXX</td>
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<td>CMEXX</td>
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<tr>
<td>Morgan Stanley</td>
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<td>MGPXX</td>
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<td>Raymond James</td>
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<td>JJGX</td>
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<td>Schwab</td>
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<td>SWGX</td>
<td>1.33%</td>
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<tr>
<td>TD Ameritrade</td>
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<td>WTUXX</td>
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<td>Crane Brokerage Sweep</td>
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<td>Crane Brokerage</td>
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<td>Crane Brokerage Cash Index</td>
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<td>0.79%</td>
<td>Money Fund 1.35%</td>
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**Top Bank Savings Rates (8/31/18)**

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<th>APY%</th>
<th>Min.</th>
<th>Account Name</th>
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<td>Pure Point Financial</td>
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<td>1.90%</td>
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<td>Online Savings</td>
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<tr>
<td>Ally Bank</td>
<td>1.85%</td>
<td>1.85%</td>
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<td>Online Savings</td>
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<tr>
<td>Barclays</td>
<td>1.85%</td>
<td>1.85%</td>
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<tr>
<td>Goldman (Marcus)</td>
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<td>1.85%</td>
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<tr>
<td>Synchrony Bank</td>
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<td>Premier Savings</td>
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<td>0.05%</td>
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<td>Max Rate Check</td>
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<tr>
<td>Crane Bank Index</td>
<td>1.41%</td>
<td>1.41%</td>
<td></td>
<td>Top 10 Bank Savings</td>
</tr>
</tbody>
</table>

**Notes:** Listings contain only high-profile, national rates.

**News:** Investment News’ “Advisers in a pickle over low-yielding cash sweep accounts” says, “[R]ising yields on some money-market funds are drawing new attention to brokerage and custodian sweep accounts, which typically pay the lowest yields on cash.”

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**Calendar**

* Money Fund University, Jan. 24-25, 2019, Stamford, Conn.
* Money Fund Symposium, June 24-26, 2019, Boston, Mass.

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**People**

- **Matt Jones** is the new Head of Liquidity reporting to Marzo Bernardi at Western Asset Management. He was previously at BlackRock.
- [Citibank Online Investments](http://www.citibankonlineinvestments.com) is seeking a Global Deposits & Investment Head to lead the team that manages their Online Investment Portal.

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measures money markets and provides competitive intelligence on money funds, bond funds & bank deposits.

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**Money Fund News** cont. from page 7

return of principal rather than a return on principal. Quite simply, they viewed cash as a very expensive insurance policy for principal safety and daily liquidity. But times are changing.”

- SEC: Private Liquidity Funds Up in Q4. The SEC’s latest quarterly *Private Funds Statistics* report, which summarizes Form PF reporting and includes some data on “Liquidity Funds,” shows a jump in overall Liquidity fund assets in the latest quarter to $579 billion.

- Capital Advisors Group Writes “Comprehensive Cash Investment Strategies: Comparing Three Major Types of Investment Vehicles.” Lance Pan tells us, “We are closing in on the 10th anniversary of the peak of the global financial crisis marked by the Lehman Brothers bankruptcy and runs on money market funds. Old-timers still remember … auction rate securities, extendable asset-backed commercial paper, structured investment vehicles, and collateralized debt obligations… To say that a lot has changed in the … cash world is a great understatement.”