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United States: Temporary Guarantee Program for Money Market Funds[1]

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Abstract

On September 16, 2008, following the collapse of Lehman Brothers, the Reserve Primary Fund "broke the buck," meaning that its net asset value (NAV) fell more than 0.5% below the $1 per share target value maintained by money-market funds (MMFs). When the Reserve Primary Fund could not restore the NAV, investors began withdrawing funds from MMFs, leading to a $439 billion run on the MMF market. To stop this run, the US Department of the Treasury established the Temporary Guarantee Program for Money Market Funds (the Guarantee Program), which insured investors' holdings in participating MMFs. The Guarantee Program was designed to protect assets held as of the announcement of the program on September 19, 2008. MMFs participating in the Guarantee Program paid a quarterly fee ranging from 1 to 1.5 basis points, depending on their NAV. The Guarantee Program, originally scheduled to last three months, was ultimately extended until September 18, 2009. During its year of operation, the Guarantee Program covered 93% of assets in the MMF market, equivalent to more than $3.2 trillion. There were no losses, and the Department of the Treasury did not make any payments through the Guarantee Program, generating a surplus of $1.2 billion in fees.

Keywords: Department of the Treasury, Exchange Stabilization Fund, Global Financial Crisis, money-market funds, Temporary Guarantee Program for Money Market Funds

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[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering account guarantee programs. Cases are available from the *Journal of Financial Crises* at https://elischolar.library.yale.edu/journal-of-financial-crises/.

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Overview

Following Lehman Brothers's declaration of bankruptcy on September 15, 2008, the value of its commercial paper declined significantly (Kacperczyk and Schnabl 2010). The Reserve Primary Fund, a money-market fund (MMF) that had $785 million of Lehman Brothers's commercial paper, was immediately affected (Kiss 2019; Kacperczyk and Schnabl 2010; McCabe 2010; SEC 2009). On September 16, 2008, these losses prompted the Reserve Primary Fund to "break the buck," reporting a net asset value (NAV) of $0.97, which was less than the standard $1 per share value typically maintained by MMFs, as it did not have the resources to restore its NAV to $1 (Macey 2011; Kacperczyk and Schnabl 2010; SEC 2009). At the time, the Securities and Exchange Commission (SEC) only required MMF managers to report the market value of their holdings when their NAV fell to less than $0.995.

Key Terms

Purpose: To "[maintain] confidence in the money market fund industry," which "is critical to protecting the integrity and stability of the global financial system"

Launch Dates	Announcement: Sept. 19, 2008 Authorization: Sept. 19, 2008, and Sept. 29, 2008 Operation: Sept. 29, 2008
End Dates	Sept. 18, 2009
Eligible Institutions	MMFs regulated under Rule 2a-7 of the Investment Company Act of 1940 with an NAV of at least $0.995 as of Sept. 19, 2008
Eligible Account(s)	MMF balances held as of the program's announcement on Sept. 19, 2008
Fees	1 to 1.5 basis points, paid quarterly, depending on the NAV of the participating MMF
Size of Guarantee	100% of all asset shortfalls
Coverage	$3.2 trillion of assets
Outcomes	No defaults; $1.2 billion in fee revenue collected
Notable Features	"Death Insurance": MMFs could exercise the guarantee only if they shut down the fund, incentivizing the parent fund to restore the NAV of the MMF Eligibility Restrictions: Only balances held as of the announcement of the program were eligible for the guarantee, preventing runs from other types of accounts into MMFs

MMFs traditionally invested only in very safe, short-term assets. However, in the lead-up to September 2008, MMFs had been investing increasingly in riskier assets to boost yields (Kiss 2019; McCabe 2010). Before 2008, the value of MMF holdings had sometimes temporarily fallen below $1, but in all but one case, parent firms had stepped in with funds to restore their NAVs to $1 (Shafran 2020). When the Reserve Primary Fund's managers could not restore its NAV to $1, this caused panic in the MMF market (SEC 2009; Kacperczyk and Schnabl 2010). Investors had not anticipated losses on MMF balances, which they previously considered safe assets. Between September 10, 2008, and October 1, 2008, they withdrew $439 billion from MMFs, including from those considered safer than the Reserve Primary Fund (Gorton and Metrick 2010; Kim 2013). The withdrawals forced many MMFs to sell assets at lower prices (Schmidt et al. 2016; Shafran 2020).

To arrest the run, on September 19, 2008, the US Treasury Department announced the Temporary Guarantee Program for Money Market Funds (the Guarantee Program) (Department of the Treasury 2008d). The Guarantee Program "insure[d] the holdings of any publicly offered eligible money market fund—both retail and institutional—that pays a fee to participate in the program" (Department of the Treasury 2008d). The Treasury funded the program through its Exchange Stabilization Fund (ESF), which had a value of $50 billion (Department of the Treasury 2008d).

The Treasury required MMFs to sign up by October 8, 2008 (Department of the Treasury 2008c; Department of the Treasury 2008g). Only MMFs that the SEC regulated under Rule 2a-7 of the Investment Company Act of 1940 were eligible (Department of the Treasury 2008f; Department of the Treasury 2008e). Participating MMFs also had to have reported an NAV of $0.995 or more on September 19, 2008 (Department of the Treasury 2008f; Department of the Treasury 2008e). The quarterly cost of enrolling varied from 1 to 1.5 basis points, depending on each MMF's NAV (Department of the Treasury 2008f; Department of the Treasury 2008e). The program covered only balances held on September 19, 2008, to prevent a run on traditional banks (Shafran 2020).

The Treasury designed the Guarantee Program as a form of "death insurance" (Shafran 2020). In cases where the NAV of an MMF fell below $0.995, the parent company retained the option to restore the value of the MMF itself (Shafran 2020). Otherwise, the MMF manager could file a claim with the Treasury (Shafran 2020). By filing a claim, the MMF manager would be forced to liquidate the fund, with the government covering any shortfalls (Shafran 2020).

The Treasury originally scheduled the program to last three months but extended it twice, ultimately until September 18, 2009 (Department of the Treasury 2008h; Department of the Treasury 2009). The Treasury allowed the program to end once liquidity returned to the market (COP 2009). During its year of operation, the program covered 93% of assets in the MMF market, equivalent to more than $3.2 trillion (COP 2009). The Treasury did not make any guarantee payments and generated $1.2 billion in fees (Shafran 2020).

Summary Evaluation

Policymakers enacted the Guarantee Program to restore confidence in the MMF market and promote the stability of the financial system (Department of the Treasury 2008d). The Congressional Oversight Panel (COP), which Congress established to monitor the Treasury's rescue programs during the crisis, credited the program with helping to stop the run on MMFs. The panel found that the program had "succeeded under [its] stated objectives" (COP 2009).

The Guarantee Program's architects often claimed its structure was the source of its success. Steven Shafran, who led the effort at Treasury, highlighted its simplicity and fairness. He noted that the terms clearly delineated which accounts were guaranteed and equitably charged them for the guarantee (Shafran 2020). Broad utilization helped reduce any stigma that might have been associated with the program (Macey 2011; Fidelity Investments 2008).

Policymakers also noted that the Treasury did not make any payments under the program. The government had initially projected that it would generate $2.5 billion in losses (COP 2009). The COP concluded that the "draconian" consequences of filing a claim with the Guarantee Program—including the reputational effects—led parent companies to bail out funds whose NAV fell below $0.995 (COP 2009). However, scholars have debated to what extent the Guarantee Program and other rescue programs launched in September and October 2008 were responsible for stopping the run on MMFs (Baba et al. 2009).

Critics raised specific concerns about the Guarantee Program. First, the COP argued that the program fostered moral hazard by creating an implicit guarantee that the government would step in if the money-market industry faced stress (COP 2009).

Second, the COP questioned whether the Treasury had the legal authority to use the ESF for the program. It noted that the Treasury had provided no legal analysis defending its authority (COP 2009; USC 1973). The COP said the Treasury's use of the ESF "mark[ed] a significant departure from prior practice" and "raise[d] the prospect of using the ESF for other domestic activities that can be plausibly linked to ensuring international financial stability" (COP 2009). Congress in October 2008 passed legislation that prohibited the secretary of the Treasury from using the ESF to guarantee MMFs without Congressional approval (Shafran 2020; Bernanke et al. 2020).[3]

Third, the COP questioned whether the Treasury had considered alternative ways to stabilize the MMF market.

Fourth, the COP criticized the Treasury's disclosures. It noted, for example, that the Treasury did not provide any analysis to address the uncertainty among market participants about the "true extent" to which it actually intended to honor the guarantees (COP 2009). The Treasury also never released a list of participants (COP 2009).

[3] In the wake of the COVID-19 pandemic, Congress passed legislation temporarily allowing the Department of the Treasury to use the ESF to guarantee accounts (CARES Act 2020; McNamara 2020).

Context: United States 2008–2009	
GDP (SAAR, nominal GDP in LCU converted to USD)	$14.6 trillion in 2008 $14.7 trillion in 2009
GDP per capita (SAAR, nominal GDP in LCU converted to USD)	$48,383 in 2008 $47,100 in 2009
Sovereign credit rating (five-year senior debt)	Data for 2008: Moody's: Aaa S&P: AAA Fitch: AAA Data for 2009: Moody's: Aaa S&P: AAA Fitch: AAA
Size of banking system	$9.9 trillion in 2008 $9.8 trillion in 2009
Size of banking system as a percentage of GDP	68.3% in 2008 66.9% in 2009
Size of banking system as a percentage of financial system	30.5% in 2008 30.3% in 2009
Five-bank concentration of banking system	44.9% in 2008 44.3% in 2009
Foreign involvement in banking system	18% in 2008 19% in 2009
Government ownership of banking system	Data not available for 2008 Data not available for 2009
Existence of deposit insurance	Yes, in 2008 Yes, in 2009
Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.	

Key Design Decisions

1. Purpose: Policymakers created the Guarantee Program to arrest runs on MMFs.

Following the collapse of Lehman Brothers, the Reserve Primary Fund, which held $785 million of Lehman's commercial paper, broke the buck—that is, it reported a net asset value (NAV) of $0.97 (Kiss 2019, 17; Kacperczyk and Schnabl 2010; McCabe 2010; SEC 2009). When the fund's managers did not quickly restore its NAV to more than the targeted $0.995, investors who had considered MMFs to be safe assets ran from MMFs across the market (SEC 2009; Kacperczyk and Schnabl 2010). Between September 10, 2008, and October 1, 2008, they withdrew $439 billion from MMFs, including from those considered safer than the Reserve Primary Fund (Gorton and Metrick 2010; Kim 2013). The withdrawals forced many MMFs to sell assets at lower prices (Schmidt et al. 2016; Shafran 2020).

The Department of the Treasury created the Guarantee Program to "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" with the hope of stopping these runs (Department of the Treasury 2008d).

2. Part of a Package: The Guarantee Program was created alongside other programs to assist MMFs, including the Federal Reserve's AMLF and MMIFF.

The Treasury announced the program on September 19, 2008. That same day, the Federal Reserve announced its Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) (Federal Reserve 2020). The AMLF, like the Guarantee Program, was created to strengthen MMFs. It provided banks with financing by purchasing high-quality asset-backed commercial paper (ABCP) from MMFs (Federal Reserve 2020). By doing so, the Federal Reserve aimed to help MMFs meet investor demands for redemptions and maintain a healthy level of market liquidity (Federal Reserve 2020).

In October 2008, the Federal Reserve announced the Money Market Investor Funding Facility (MMIFF), which was meant to aid the money-market industry by providing liquidity to its investors (Federal Reserve 2010; Wiggins 2020).

3. Legal Authority: The Treasury used its authority under the Gold Reserve Act of 1934, which had established the Exchange Stabilization Fund (ESF), to create the Guarantee Program.

The Gold Reserve Act of 1934, as amended in 1976, allowed the secretary of the Treasury, with the president's approval, to use the ESF to fulfill "obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates" (Gold Reserve Act 1934; Bretton Woods Amendments 1976; USC 1973; Department of the Treasury 2008d). The Act allowed the Treasury to "deal in gold, foreign exchange, and other instruments of credit and securities" (Gold Reserve Act 1934; Department of the Treasury 2008d). Prior to the Guarantee Program, the Treasury used the

ESF for various purposes, including the stabilization of exchange rates, stabilization loans, and warehousing (Humpage 2008).

The Congressional Oversight Panel (COP), among others, questioned whether the language of the Gold Reserve Act allowed the Treasury to use the ESF to support MMFs. In October 2008, Congress passed legislation that prohibited the Treasury from doing so again without specific Congressional approval (Shafran 2020). Congress temporarily provided that approval in 2020 during the COVID-19 pandemic, although in that case the Treasury did not reintroduce an MMF guarantee (CARES Act 2020; McNamara 2020).

4. Administration: The Treasury administered the Guarantee Program.

The Treasury ran the Guarantee Program (Department of the Treasury 2008d). To enroll in the program, MMF managers had to submit a signed agreement and disclose information to the Treasury about their funds, including the number of shares the MMF held, their NAV, their maturity, and the total number of shareholders (Department of the Treasury 2008b; Department of the Treasury 2008a).

In cases where an MMF exercised the Treasury's guarantee, the MMF was required to notify the Treasury (Shafran 2020).

5. Governance: Congress exercised its oversight powers over the Guarantee Program. Other regulatory agencies also announced rules pertaining to the program.

Several private and governmental agencies adopted new regulatory guidance to support the Guarantee Program. For instance, the Financial Industry Regulatory Authority released guidance on how MMFs should disclose their involvement in the Guarantee Program (FINRA 2008). The Internal Revenue Service also released regulatory guidance regarding the tax effects of the Guarantee Program (IRS 2008b; IRS 2008a).

Congress maintained some oversight over the Guarantee Program. Notably, the COP examined the efficacy of the government's economic programs, including the Guarantee Program (COP 2009).

6. Communication: The Treasury said that the Guarantee Program was meant to maintain confidence in the MMF industry and to ensure global financial stability.

On September 19, 2008, when the Guarantee Program was announced, the Treasury noted two goals: to maintain confidence in MMFs, which were an important financial instrument in the US, and to promote global financial stability (Department of the Treasury 2008d). Then-Secretary of the Treasury Henry J. Paulson, Jr., in testimony before Congress, stated that such interventions were designed to protect American taxpayers by stabilizing the financial system (Paulson 2008).

7. Size of Guarantees: The Guarantee Program was meant to cover 100% of investor losses in eligible MMFs once an MMF had been liquidated.

The Guarantee Program was designed to cover 100% of asset shortfalls once an MMF had been liquidated (Shafran 2020).

8. Source(s) and Size of Funding: The Treasury used $50 billion from the ESF to fund the Guarantee Program.

The Treasury used $50 billion from the ESF to back the Guarantee Program (Shafran 2020). Architects of the program believed that because they were fighting a liquidity run, any losses would be minimal and the $50 billion sufficient to insure the $3.5 trillion MMF market (Shafran 2020).

9. Eligible Institutions: All MMFs regulated under Rule 2a-7 of the Investment Company Act of 1940 were eligible for the Guarantee Program. Additionally, an MMF had to have an NAV of $0.995 or more on September 19, 2008.

The Guarantee Program was available to all MMFs regulated under Rule 2a-7 of the Investment Company Act of 1940 (Department of the Treasury 2008f). Rule 2a-7 differentiates MMFs from other mutual funds and limits their "credit, interest-rate, and liquidity risks consistent with the funds' maintenance of a stable NAV" (McCabe 2010). These MMFs, both retail and institutional and taxable and nontaxable, were required to register with the SEC and maintain a normal share price of $1 per share (Department of the Treasury 2008f). Only MMFs could enroll in the Guarantee Program (Department of the Treasury 2008c). Fund managers wishing to participate were required to enroll in the Guarantee Program starting in October 2008 and then extend their participation, if they wished, once the Guarantee Program was extended (Department of the Treasury 2009; Department of the Treasury 2008g; Department of the Treasury 2008h).

Participating MMFs were required to have an NAV at or above $0.995 on September 19, 2008 (Department of the Treasury 2008f). Architects of the program chose this cutoff to prevent damaging runs while at the same time not curing "losses that had already been sustained (because of credit mistakes) at the few funds that were already in trouble" (Shafran 2020).

At its height, the Guarantee Program covered 366 MMF-management companies and 1,486 individual funds (Shafran 2020). All of the largest MMF firms had enrolled by October 1, 2008 (Macey 2011). However, as liquidity returned to the financial system, not all institutions remained in the program (Shafran 2020).

10. Eligible Accounts: The Treasury limited the Guarantee Program to MMFs held on September 19, 2008.

The Treasury only insured MMF balances held as of the program's announcement on September 19, 2008 (Department of the Treasury 2008f). This was intended to discourage investors from moving money from traditional banks to MMFs to take advantage of the new guarantee. Policymakers worried that the program could create a run on traditional banks

(Shafran 2020). Given that investors who invested in MMFs after the announcement of the Guarantee Program were not covered by the guarantee, there was no incentive to shift funds from traditional banks to MMFs to take advantage of it.

11. Fees: Quarterly fees for the Guarantee Program originally ranged from 1 to 1.5 basis points, depending on the NAV of the MMF. Over time, the fees increased.

When it announced the Guarantee Program in September 2008, the Treasury charged quarterly fees to participating institutions that varied according to the NAV of the MMF (Department of the Treasury 2008f). For MMFs with NAVs equal to or greater than $0.9975 at the close of business on September 19, 2008, the Treasury charged one basis point on the size of the insured fund (Department of the Treasury 2008f). For MMFs with NAVs equal to or greater than $0.995 on September 19, 2008, the Treasury charged 1.5 basis points (Department of the Treasury 2008f). These fees were meant to cover the first three months of participation in the program (Department of the Treasury 2008f).

When the Guarantee Program was extended in November 2008, the Treasury increased the quarterly fees. For MMFs with NAVs equal to or greater than $0.9975 on September 19, 2008, it raised the fee to 1.5 basis points (Department of the Treasury 2008h). For MMFs with NAVs equal to or greater than $0.995 on September 19, 2008, it raised the fee to 2.2 basis points (Department of the Treasury 2008h). These fees were meant to cover the costs of participation in the program until April 30, 2009 (Department of the Treasury 2008h).

The Treasury revised the fees again in March 2009, when it extended the program until September 2009 (Department of the Treasury 2009). This time, the fees covered a six-month period rather than a quarter (Department of the Treasury 2009). For MMFs with NAVs equal to or greater than $0.9975 on September 19, 2008, the Treasury charged 1.5 basis points on the size of the insured fund (Department of the Treasury 2009). For MMFs with NAVs equal to or greater than $0.995 on September 19, 2008, it charged 2.3 basis points (Department of the Treasury 2009).

The Treasury decided on the size of the fees to encourage mass participation while also charging "something that would be meaningful as a percentage of the margins earned by most managers" (Shafran 2020). The three payments MMFs made summed to 4 to 6 basis points per year, depending on their NAVs (Shafran 2020). This range was based on the Treasury's estimate that MMF profits ranged from 4 to 10 basis points per year (Shafran 2020). Moreover, though the Department of the Treasury sought to charge firms fees that were meaningful, the COP said that "the fees the government charged the financial institutions for the guarantees in all of the programs were lower than fees commercial entities would have charged for the same protection," leading to potential moral-hazard concerns (COP 2009).

12. Process for Exercising Guarantee: To exercise the guarantee, fund managers were required to notify the Treasury and halt redemptions. Then the MMF was liquidated and any shortfalls covered by the Guarantee Program.

The Guarantee Program was created as a form of "death insurance," meaning that an MMF manager who wanted to exercise the program's guarantee had to shut down the fund (Shafran 2020). To exercise the guarantee, the NAV of an MMF had to fall below $0.995, what was termed a "Triggering Event" (Shafran 2020). The parent company, then, could restore the value of the MMF (Shafran 2020). However, if the parent company decided not to restore the value of the MMF or could not do so, the MMF could file a claim with the Treasury within 24 hours of the Triggering Event (Shafran 2020). Upon filing the claim, the MMF would be required to stop redemptions. Next, within five days, the assets in the MMF would be liquidated, with the proceeds going to investors (Shafran 2020). Within 30 days of the Triggering Event, the MMF could file a claim with the Treasury to cover any shortfalls (Shafran 2020). Requiring an MMF that used the guarantee to liquidate created incentives for parent companies to restore the NAVs of their MMFs. Liquidation would have "draconian" consequences, including negative reputational effects (COP 2009).

13. Other Restrictions on Eligible Institutions/Accounts: There were no other conditions associated with the Guarantee Program.

The Guarantee Program had no other conditions (Department of the Treasury 2008f).

14. Duration: The Guarantee Program was originally scheduled to last three months but was extended twice and ultimately lasted a year.

The Guarantee Program was originally established for three months, after which the secretary of the Treasury was to decide whether to extend or terminate it (Department of the Treasury 2008f). Later, in November 2008, the Treasury extended the Guarantee Program until the end of April 2009 (Department of the Treasury 2008h). Again, the secretary of the Treasury had the power to extend or terminate the Guarantee Program after this date (Department of the Treasury 2008h). In March 2009, the secretary of the Treasury extended the Guarantee Program through September 18, 2009, on which date the Guarantee Program ultimately ended as scheduled (Department of the Treasury 2009).

Architects of the Guarantee Program have noted that a clear termination date was crucial so that "everyone [would] understand we were not looking to permanently reshape the industry" (Shafran 2020).

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