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Sizing up 'safe harbor' money markets

By Walter Updegrave, Money Magazine senior editor
October 1, 2008 5:36 pm

Question: I've been hearing a lot of talk of late about the safety of money market accounts, so I'm wondering if the money I have in a money market account with my bank is secure. Is it?
—*M.S., Atlanta,* Georgia

Answer: I think your worries may stem from the possibility that that you're confusing two types of savings vehicles with similar names. I'm talking, of course, about bank money market accounts and money market mutual funds.

But even though their names sound alike - and investors have historically relied on both as safe places to stash their cash - the fact is that these two vehicles are actually quite different.

So it's important that you as well as other savers and investors understand which type of account you actually have and what sort of security you can expect from it.

Bank money market accounts

These are deposit accounts offered by banks. Indeed, sometimes they are called money market deposit accounts to differentiate them from money market mutual funds. Essentially, bank money market accounts are nothing more than savings accounts that allow you to write checks (up to three a month) and that pay a higher rate of interest than you would receive on a regular savings or interest-bearing checking account. In return for that higher rate of interest, you must typically maintain a minimum balance, usually between $1,000 and $2,500.

As far as the safety of your money is concerned, the important thing is about bank money market accounts is that they are insured by the FDIC. So if your bank were to fail, the money you have in a bank money market account in your name would qualify for up to $100,000 in deposit insurance, or as much $250,000 of insurance if your money market account is held in an IRA or other retirement account.* (I'm oversimplifying the coverage rules here. For details, I suggest you read a previous column and the deposit insurance section of the FDIC site.)

But the point is that as long as the money you have in a bank money market account falls within the FDIC insurance limits, you will not lose a cent even if your bank goes down the tubes.

Money market funds

These are a type of mutual fund. Unlike stock or bond mutual funds, money market funds invest in very short-term debt securities, including Treasury bills, commercial paper (a form of corporate IOUs), bank deposits as well as more arcane instruments.

Money market mutual funds don't qualify for FDIC insurance, even if you buy the money market fund at your bank. But the idea is that by limiting themselves to high-quality securities with short-term maturities, money market funds should be able to maintain a stable share price of $1. And with one exception, they've been able to do just that, until two weeks ago.

That's when problems in the credit markets led to one money market fund "breaking the buck," which means its price slipped below $1 per share. That has led investors to question the safety of these funds, and that accounts for all the talk you've heard, although the discussion has centered on money market funds, not bank money market accounts.

Are you protected?

To allay investors' concerns about money market funds, the Treasury Department has created a guarantee program. designed to protect money market

fund shareholders from losses. But this program isn't as comprehensive as FDIC insurance. For one thing, participation is voluntary; only money market funds that pay a fee to join the program will be covered. Even then, not all shareholders' money in a participating fund qualifies for the guarantee. The guarantee covers only the number of shares you owned in a participating fund as of September 19. And the program is temporary. It will be in effect for three months initially, and the Treasury secretary has the option of extending it through September 18, 2009.

So far, according to Crane Data, which is keeping a tally of funds that sign up for the Treasury program more than 10 companies, including Schwab, Putnam, Dreyfus and Morgan Stanley, have enrolled or are in the process of signing on to the program. Others are still mulling it until the October 8 deadline. To find out if your money market fund has joined or plans to, you can call your fund company.

Despite the problems that some money market funds have had recently, I still believe they offer a high level of safety, even apart from additional protections that may be afforded by Treasury's guarantee program. As I've noted before, I think your chances of losing money in a money market funds are small if you stick to the funds of large, well-known fund companies that are likely to shore up their fund if it runs into problems. You can reduce those odds even more if you stick to money market funds that invest only in Treasury securities.

But aside from assets guaranteed by the Treasury, this protection isn't absolute. When the markets are as haywire as they are today, it's possible to imagine scenarios where even the highest-quality money-market fund could post a loss, although I'd expect it to be small, say, a few cents a share. If that type of scenario, no matter how unlikely, keeps you up at night, then you might want to keep your cash reserves in a money market deposit account that's covered by FDIC insurance (or accounts at multiple banks if that's what it takes to assure you're fully protected).

Then again, if the situation with the economy and the financial system deteriorates to the point where money market funds are routinely breaking the buck, small losses in money market funds may very be the least of our worries.

**Editor's note: Last night the Senate passed a bailout package that, among other things, would temporarily increase the $100,000 deposit insurance limit to $250,000. For the higher limit to become effective, however, the House would have also to approve it and the president would have to sign the measure.*

Be careful of the mutual fund money market funds. Look at the current problems surrounding the Reserve Primary Fund, where (after the collapse of Lehman) investors might now get back just 32 cents on their dollar (details pending).

In addition to this flagship failure, the Reserve family's other funds (over 20) have been frozen even though the SEC only authorized freezing 2 of them initially. This apparent breach of the law without meaningful comment from either the funds nor the SEC has investors very concerned. Surprisingly, even the Reserve US Treasury Fund has also been frozen - which, if it has been managed as it was advertised, should only contain US treasuries and be completely liquid.

Be very careful when considering the money market mutual funds. Even in a supposedly safe fund, how do you know the fund managers are doing what they said they would do? And what guarantee do you have to your money if the fund can withhold it at will?

Posted By J in San Francisco: October 2, 2008 12:58 pm

"Having you money FDIC insured doesn't mean anything. What the public doesn't know, is that, the FDIC has 99 1/2 years to pay back your moeny, if lost. So in reality, you DO lose your money. You won't get it back in this lifetime if all banks were to fail."

I couldn't find anything like that in the FDIC regulations: http://www.fdic.gov/regulations/laws/rules/

I did see things talking about how they have to repay the money as quickly as possible.

Banks have failed before and people have gotten paid. Yes, it does sometimes take months, or a year or more, to get all the money, especially if there are criminal investigations connected to the failure.

"What about CDs, are they safe?"

CDs are covered by the FDIC, but I'm not sure if they are considered separate from savings accounts at the same bank (ie, if you have $100K in a savings account, and $50K in CDs, you might only be covered for $100K total.)

Posted By Matt I, Cambridge, MA: October 2, 2008 11:53 am

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Posted By J, from LA: October 2, 2008 11:16 am

401k money in "cash" is often in a MMMF, which leaves no truly safe place to run. I wonder if companies consider that they have taken employees money hostage, and what will happen if one of the 401k companies (Fidelity, Vanguard, State St. etc.) breaks the buck in their MMMF.

Posted By Bill, Sudbury MA: October 2, 2008 10:42 am

Cash or cash-like instruments (e.g. CDs) are covered @ up to $100k ($250k for IRAs or qualified retirement plans) by the FDIC per institution, per

SSN.

Posted By Micah, Cincinnati, OH: October 2, 2008 10:06 am

The article doesn't mention SIPC insurance because it really isn't applicable. Yes, it covers 400k in securities and 100k in cash, but it will do nothing in the event that the fund takes a loss. SIPC covers broker fraud and embezzlement and only guarantees the actual securities held, not the value.

Posted By Chris, Provo UT: October 2, 2008 10:05 am

The Senate bill that was passed last night TEMPORARILY increases the $100,000 FDIC insurance to $250,000, only through Dec 31, 2009. It is interesting that this has not been mentioned in the news.

Posted By A, Boston, MA: October 2, 2008 9:51 am

This article fails to mention the insurance provided on the money market mutual funds by the Securities Investor Protection Corporation (SIPC) should your borkerage firm fail. The coverage is up to $500,000.00 for your total invested funds. The coverage does not protect you against a loss, however, less than a handful of the 100's of fund have lost value. Even in these troubled times, it is extremely rare for the money market mutual funds to lose value.

Posted By Michael in Austin, TX: October 2, 2008 8:45 am

What about CDs, are they safe?

Posted By Ihab, Aldie VA: October 2, 2008 8:20 am

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