Overview

On October 21, 2008, the Board of Governors of the Federal Reserve System (Board), by the unanimous vote of its five members, approved under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343) the establishment of the Money Market Investor Funding Facility (MMIFF). The MMIFF complements the Federal Reserve’s existing credit facilities by helping provide liquidity to money market investors and thereby increasing the availability of credit. The MMIFF will be a credit facility provided by the Federal Reserve Bank of New York (the Reserve Bank) to a series of special purpose vehicles established by the private sector (PSPVs) in accordance with the terms described below. Each PSPV will purchase eligible money market instruments from eligible money market investors using financing from the MMIFF and from the issuance of asset-backed commercial paper (ABCP) to investors.

Background and Details on the MMIFF

Prime money market mutual funds are an important source of financing for financial institutions and non-financial businesses. Certificates of deposit, commercial paper, and bank notes (“money market instruments”) issued by large financial institutions make up a substantial part of the holdings of prime money market mutual funds.

The money markets have been under considerable strain since mid-September, when prime money market mutual funds began to experience high levels of redemption requests. The redemptions placed considerable pressure on the liquidity of these mutual funds. As a result, prime money market mutual funds have sold a large amount of money market instruments and have become increasingly reluctant to purchase additional money market instruments, especially at longer-dated maturities. Accordingly, interest rates on longer-term money market instruments have risen significantly, and an increasingly high percentage of outstanding money market instruments are issued on an overnight basis. A large share of outstanding money market instruments are issued by financial intermediaries, and their difficulties borrowing in the short-term debt markets also
have made it more difficult for them to play their vital role in meeting the credit needs of businesses and households. These factors, when combined with the ongoing stresses in other parts of the credit markets, have presented significant risks to financial stability and economic conditions in the United States.

In light of the foregoing, the Board determined that unusual and exigent circumstances existed that warranted approval of the MMIFF. By facilitating sales of money market instruments in the secondary market, the MMIFF is designed to reduce the liquidity risk faced by U.S. money market mutual funds and other U.S. money market investors, and thereby encourage such investors to once again engage in purchases of term money market instruments. Improved money market conditions will enhance the ability of banks and other financial intermediaries to accommodate the credit needs of businesses and households.

**Structure and Basic Terms.** The Board expects that the MMIFF will be operational in the next several weeks. The following provides an overview of the terms and conditions that are expected to govern the MMIFF at this time. The Board and Reserve Bank continue to monitor the money markets and to consult with market participants and, accordingly, the terms and conditions governing the facility may be modified in the future.

Under the MMIFF, the Reserve Bank will provide senior secured funding to a series of PSPVs to finance the purchase of eligible assets from eligible investors at amortized cost. Initially, there will be five PSPVs. Eligible assets and eligible investors are described in more detail below. Each PSPV will finance its purchases of eligible assets by selling ABCP and by borrowing under the MMIFF. The PSPV will issue to the seller of the eligible asset subordinated ABCP equal to 10 percent of the asset’s purchase price. The ABCP will be rated at least A-1/P-1/F1 (the highest short-term rating category) by two or more major nationally recognized statistical rating organizations (NRSROs). The Reserve Bank will lend to each PSPV, on a senior secured basis, 90 percent of the purchase price of each eligible asset. The PSPVs will hold the eligible assets until they mature, and proceeds from the assets will be used to repay the Federal Reserve loan and the ABCP. First losses in a PSPV will be absorbed by the holders of the ABCP issued by the PSPV.

**Assets Eligible to be Purchased by a PSPV.** Each PSPV will purchase only U.S. dollar-denominated certificates of deposit, bank notes, and commercial paper with a remaining maturity of 90 days or less. Each of the five PSPVs will purchase debt instruments issued by ten financial institutions designated in its operational
documents. Each of these fifty financial institutions will have a short-term debt rating of at least A-1/P-1/F1 from two or more major NRSROs.

The fifty financial institutions were chosen by representatives of the U.S. money market mutual fund industry. The financial institutions were chosen primarily because they are among the largest issuers of highly rated short-term liabilities held by money market mutual funds, but also with an objective of achieving geographical diversification in each PSPV. The financial institutions include most of the largest global North American and European financial institutions.

This eligible asset framework was devised to accommodate the requirements of investors and the NRSROs.

Concentration Limits for Eligible Assets. At the time of a PSPV’s purchase from an eligible investor of a debt instrument issued by one of the 50 financial institutions, debt instruments issued by that financial institution generally may not constitute more than 15 percent of the assets of the PSPV.

Investors Eligible to Sell Assets to a PSPV. Eligible investors initially will include U.S. money market mutual funds that are registered under the Investment Company Act of 1940 and that operate in accordance with SEC Rule 2a-7 issued under that act. Over time, eligible investors may include other U.S. money market investors.

Limits per Eligible Investor. The MMIFF program documents will not limit how much a single investor may sell to a PSPV. SEC Rule 2a-7 under the Investment Company Act of 1940 and the SEC’s interpretations thereof, however, may place quantitative limits on the ability of money market mutual funds to sell assets to the PSPVs.

Maximum Size of the MMIFF. The initial set of five PSPVs will be authorized, in total, to purchase a maximum amount of $600 billion in eligible assets. Because the Reserve Bank will provide 90 percent of the financing for the PSPVs, Federal Reserve lending could total $540 billion.

Terms of Federal Reserve Lending. The Reserve Bank will lend to the PSPVs at the primary credit rate, currently 1.75 percent. In order to reduce the interest rate risk of the PSPVs, however, the Reserve Bank will subordinate its right to receive certain amounts of potential interest payments. Specifically, if the
primary credit rate rises above 2.25 percent, the Reserve Bank’s right to receive interest above 2.25 percent will be subordinated to the rights of the ABCP holders to receive principal and interest. Any accumulated income in a PSPV not distributed to the ABCP investors will accrue to the Reserve Bank.

**Security for Federal Reserve Advances.** The Reserve Bank loans under the MMIFF will be fully collateralized by all the assets of the PSPVs. As noted above, these assets will be short-term, high-credit-quality debt instruments. In addition, the ABCP issued by each PSPV and held by the investors will be subordinated to the Reserve Bank loans and will absorb approximately the first ten percent of any losses incurred by the PSPV. Moreover, any excess spread earned by the PSPVs will be retained in the PSPVs and will serve as a further buffer against loss.

**Termination Date.** The PSPVs will cease purchasing assets on April 30, 2009, unless the Board agrees to extend the MMIFF. The Reserve Bank will continue to fund the PSPVs after such date until the PSPVs’ underlying assets mature.

**Expected Costs.** In light of the high-credit-quality, short-term money market instruments to be acquired by the PSPVs, the ten percent minimum equity cushion in each PSPV, and the excess spread that is expected to accumulate in each PSPV, the Board does not expect at this time that advances under the MMIFF will result in any losses to the Federal Reserve or the taxpayer.