How banks and regulators react to each other helps explain how the money market fund industry has evolved.

In this paper, we present empirical evidence of the regulatory dialectic in the prime institutional money market fund (PI-MMF) industry. The regulatory dialectic describes how banks and regulators react to each other. For decades, a cap on commercial deposit interest rates fueled dramatic growth in bank-sponsored PI-MMFs as a form of shadow banking. During the growth period, banks with more commercial deposits were more likely to enter the PI-MMF industry in an effort to keep their commercial customers in affiliated subsidiaries. However, the 2008 crisis and subsequent regulatory changes halted the rapid growth of PI-MMFs. In the post-crisis regulatory regime, bank-sponsored funds were more likely to exit the industry than nonbank-sponsored funds. Simultaneously, the industry shifted from PI-MMFs to government institutional MMFs as substitute products.

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