Further Changes for Money Funds?

Proposed legislation in the House and Senate would let funds go back to using stable NAVs.

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As the one-year anniversary of new regulations affecting money market funds approaches this fall, the money fund landscape seems permanently altered. The imposition of floating net asset values and fees and gates on institutional prime and municipal funds scared away investors, shrinking the assets held in those types of funds.

That decline, and the impact it had on corporations and state and local governments that financed themselves by issuing short-term debt sold to money market funds, has sparked a legislative response. But the measures proposed in the House and Senate may have a hard time making headway given all the other issues Congress has to deal with.

As of last October, the Securities and Exchange Commission required institutional prime and municipal money market funds to implement a floating net asset value, rather than the constant NAV of $1 a share that had been typical for U.S. money funds. Prime and municipal funds were also subject to liquidity fees and gates.

As the implementation date for the new rules approached, there was a massive shift in assets, particularly out of institutional prime funds into government funds. As of Aug. 2, institutional prime funds contained about $172.7 billion in assets. That’s up from $123.9 billion at the end of last year, after the new regulations took effect, but far below the $779.1 billion the funds held at the start of 2016.

Corporations were among the investors retreating from prime funds. The Association for Financial Professionals’ annual Liquidity Survey released last month showed companies surveyed had just 2% of their assets in prime funds, down from 9% last year, and 14% in government and Treasury funds, up from 7% last year.

Finance professionals have yet to warm up to the floating NAV funds. Forty-one percent of those responding to the AFP survey said their company would not invest in prime funds. Another 23% said they would consider using prime funds if the NAV doesn’t fluctuate much, and 20% said they would go back into prime funds if the spread became attractive enough.

Legislation Proposed

The legislation in the House and Senate would allow money market funds to elect to operate with a stable net asset value (NAV), rather than a floating NAV, if they meet certain criteria.

The Consumer Financial Choice and Capital Markets Protection Act (H.R. 2319), introduced by Rep. Keith Rothfus, R-Pa., has 27 cosponsors, 14 of them Democrats. The Senate version, introduced by Sen. Pat Toomey, R-Pa., has three cosponsors, two of whom are Democrats.

Tom Hunt, director of treasury services at the AFP, noted the strong bipartisan support for the bill in the House, and said the measure also fits with the Trump administration’s interest in the unintended consequences of regulatory form.

“It’s got the ear of a lot of people and it’s gaining steam,” he said. “There’s a good chance it will go forward.”

The AFP is a member of the Coalition to Protect Investor Choice, a group promoting the legislation. The majority of supporters listed on the group’s website are state and local government officials and organizations, and Hunt said the proposed legislation is “resonating most strongly” on the municipal side.

“They’ve been hit harder on the fund side and more so on the issuance side,” he said.

Tony Carfang, a partner at consulting firm Treasury Strategies, said municipal funds felt the pinch from the regulatory changes before corporates, while big corporates have an easier time replacing any funding they're no longer able to obtain by selling commercial paper than states and municipalities do.

Most fund companies aren't pushing for the legislation. But Carfang said that while much of the money in prime funds has ended up in government funds, fund companies risk losing a large portion of those assets once short-term investors figure out where else to invest them.

"Except for sweep accounts, in the absence of any change in regulation, we don't expect the vast majority of this money to remain in money market funds," he said. "The treasurer will have better investment options elsewhere."

"There is a widening spread between prime and government funds, so from an investing standpoint, investors are beginning to see a real loss in yield by not having prime funds available," Carfang added.

But Lance Pan, director of investment research and strategy at Capital Advisors Group, was not optimistic about the prospects for the legislation, noting that Congress is occupied with issues including health care, taxes and trade.

"There's so many larger problems for Congress to solve, I really don't see this going back to stabilized NAV as something that can be introduced," Pan said. "It could work into an add-on item in a bill, but I don't see the widespread support in Congress to put their capital behind this proposal."

Short-Term Investing Trends

AFP's Liquidity Survey showed corporations are still relying on banks as a repository for much of their short-term cash: 53% of all assets are in bank deposits, down from 55% last year. That's followed by the 14% of assets invested in government and Treasury money funds and 5% in Treasury bills.

As corporate treasuries prepared for the changes in prime funds, there has been a lot of interest in separately managed accounts as an alternative short-term investment. Thirty-one percent of those surveyed said they were looking at SMAs, down from 34% in last year's survey. But the portion of assets held in SMAs stood at 4%, up from 3% last year.

Hunt said some companies find the costs involved, which include investment management fees, custodian fees and compliance reporting, are too high. He estimated a company would have to invest several hundred million dollars to reach economies of scale.

Pan said investors remain hesitant to make changes to their short-term investments, in part because they're waiting to see how the Trump administration's policies develop in areas like tax reform.

"That's something we noticed more this year," he said. "When we talk to people, they're saying, 'Let's just wait. We don't see a clear path forward, we'll just wait for a few more months.'"