

# Corporate Investing Post-Money Fund Reform

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Presented By



FitchRatings



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# Regulation Impacts Every Money Market and Deposit Instrument Available to Treasurers

FitchRatings

Treasury Strategies

**Massive**



**Intrusive**



**Global**



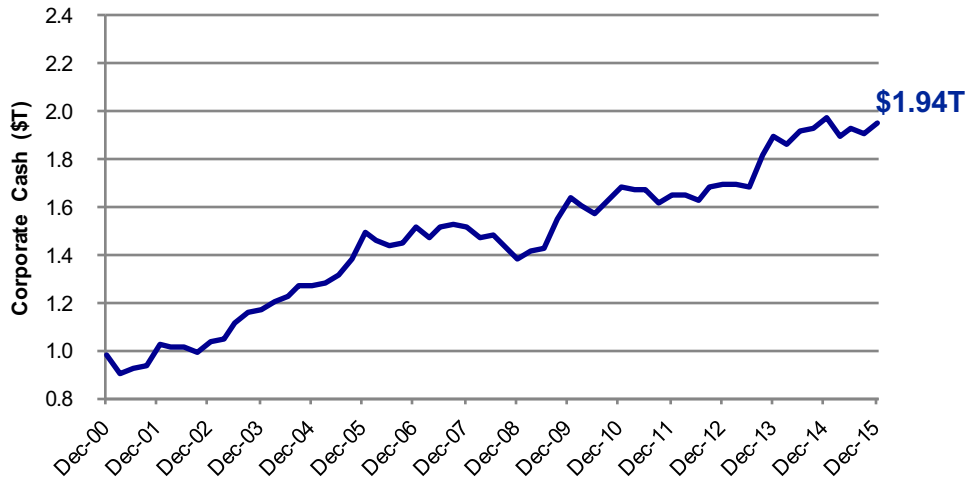
# A New Landscape for Cash Management



Challenge	Impact
<p><b>Money Fund Regulations:</b> Institutional prime money funds to “float” NAV and adopt “fees &amp; gates”; constant NAV government money funds will continue to exist without “fees &amp; gates.”</p>	<p>Potential losses on cash held in prime funds and/or restricted access to liquidity during stress</p> <p>Lower yields on government funds as demand overwhelms supply</p>
<p><b>Basel III:</b> Regulations penalize banks for relying on less-stable wholesale short-term funding.</p>	<p>Banks to turn away certain corporate deposits</p> <p>Reduced bank issuance of short-term debt, limiting the supply of high-quality, short-term investments</p>
<p><b>Alternative Cash Management Products:</b> Money fund regulation is leading asset managers to develop “alternative” cash management products such as private unregistered funds, short-term bond funds, separately-managed accounts and 60-day maximum maturity money funds.</p>	<p>Treasurers and cash managers required to evaluate the new products and update investment guidelines to incorporate these new strategies</p> <p>Emerging products that are not as tightly regulated as traditional money funds, allowing for greater flexibility, but also the potential for greater risk and less transparency</p>
<p><b>Low or Negative Yields:</b> Yields in the U.S. remain extremely low and have turned negative in Europe, while the supply of high-quality, short-term securities continues to shrink.</p>	<p>Treasury professionals needing to re-think their cash management strategies and policies and better segment cash that does not serve a near-term operational need</p>
<p><b>Material Changes In Rating Agency Criteria and Coverage:</b> Post-crisis, there has been a material change in the markets covered by the “big three” rating agencies and increasingly divergent criteria for rating money funds.</p>	<p>Outdated investment guidelines that fail to include all of the “big three” rating agencies (Fitch, S&amp;P and Moody’s) who are out of step with market realities and best practices and that may unnecessarily restrict cash management options; rating criteria for money funds that varies across all three agencies and creates new risks</p>

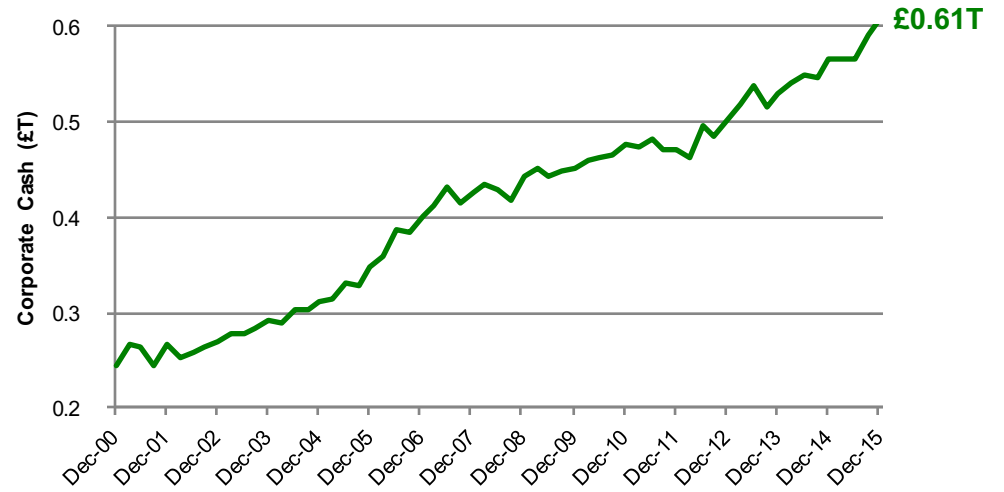
# Corporate Cash Levels – Higher Than Ever

### US Corporate Cash



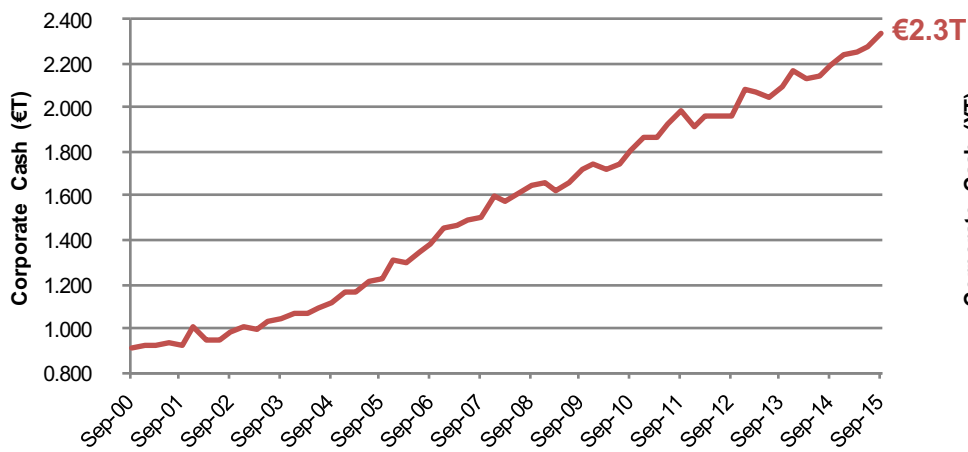
Source: Federal Reserve, Treasury Strategies

### UK Corporate Cash



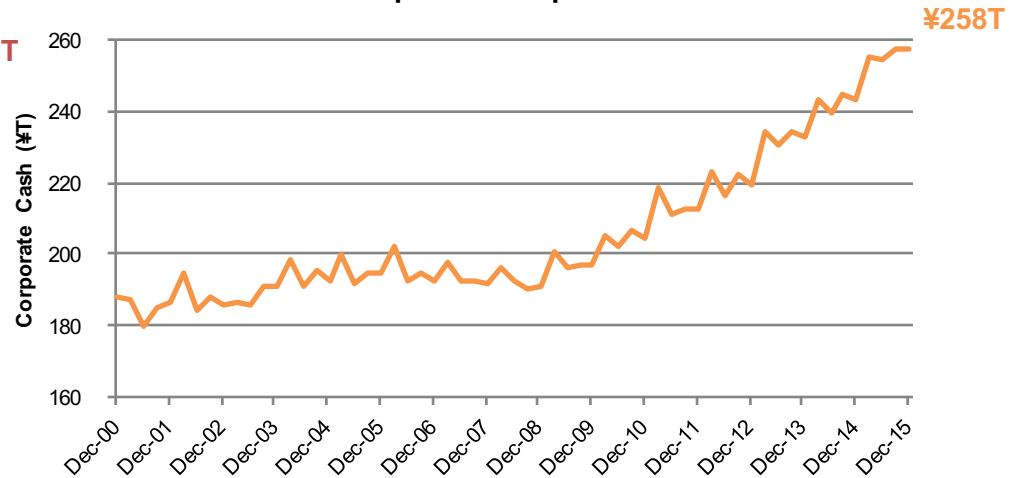
Source: UK Office for National Statistics, Treasury Strategies

### Eurozone Corporate Cash



Source: European Central Bank, Treasury Strategies

### Japanese Corporate Cash



Source: Bank of Japan, Treasury Strategies

# Cash Investment Options



Value Drivers	Prime MMF	Treasury MMF	T-Bills/ Repo	Bank DDA	Ultra-Short Bond Funds	Direct CP	SMA's	In-House Mgt
High relative yield	X				X	X	X	X
Daily liquidity	X	X	X	X	X	X		
Ultra-low risk	X	X	X	X				
Low minimum transaction size	X	X		X	X			X
Low fees	X	X	X	X		X	X	X
Diversification	X	X			X		X	
Convenience	X	X		X				
TMS connectivity	X	X	X	X				
Portfolio accounting	X	X		X	X		X	
Professional management	X	X		X	X		X	

Source: Treasury Strategies



# The Market Already Imposes VNAV, Fees and Gates on All Other Instruments



## VNAV

- Treasuries
- Agencies
- CP

## Fees

- Bank deposits
- CP and other money market instruments

## Gates

- Banks – suspension of convertibility
- FDIC resolution
- Liquidity gaps
- Auction rate securities

## Value Proposition of Money Market Instruments

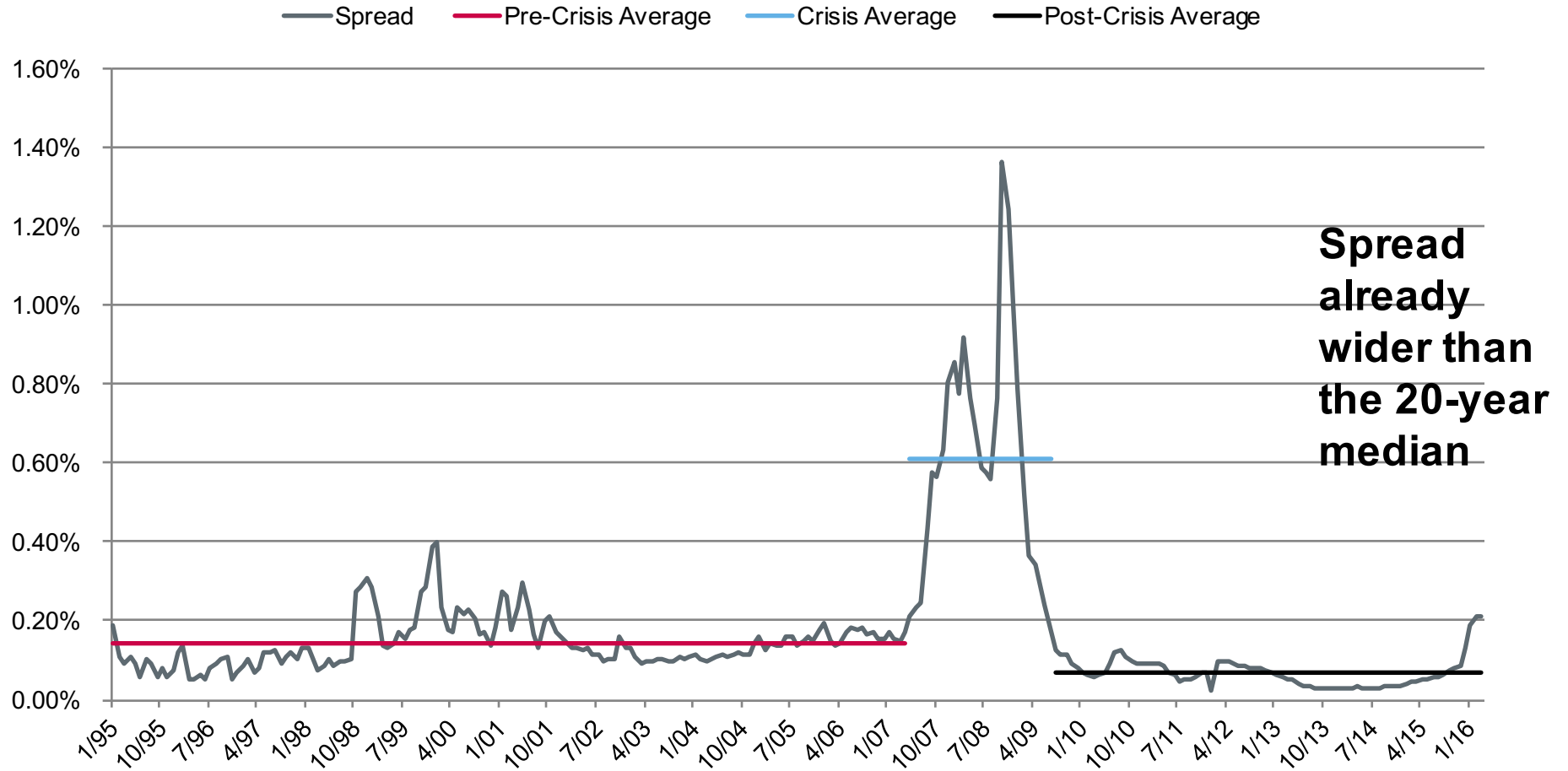


Investor utility of each instrument before and after the post-crisis regulations (Dodd-Frank, Basel III, MMF):

Instrument	Before	After
Prime money funds	95	92
Treasury/government MMFs	92	90
Treasury bills – direct	90	88
Bank demand deposits	85	80
Ultra-short bond funds	80	80
Commercial paper – direct	75	70
SMA	60–80	55–75
Internally-managed portfolios	40–80	35–75

Source: Treasury Strategies' corporate clients' experience

# Trends to Watch – Spreads in Yield Between Prime and Government Money Funds

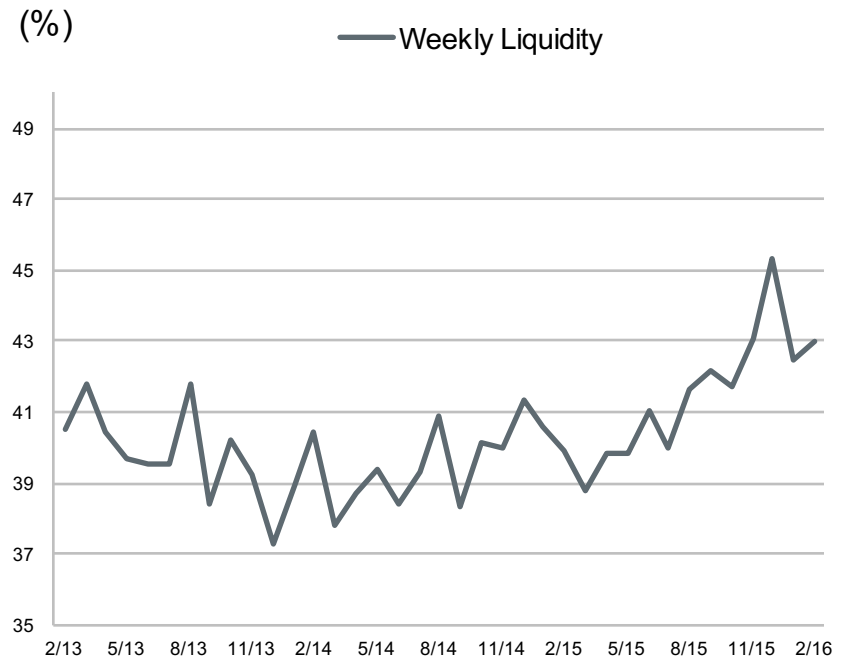
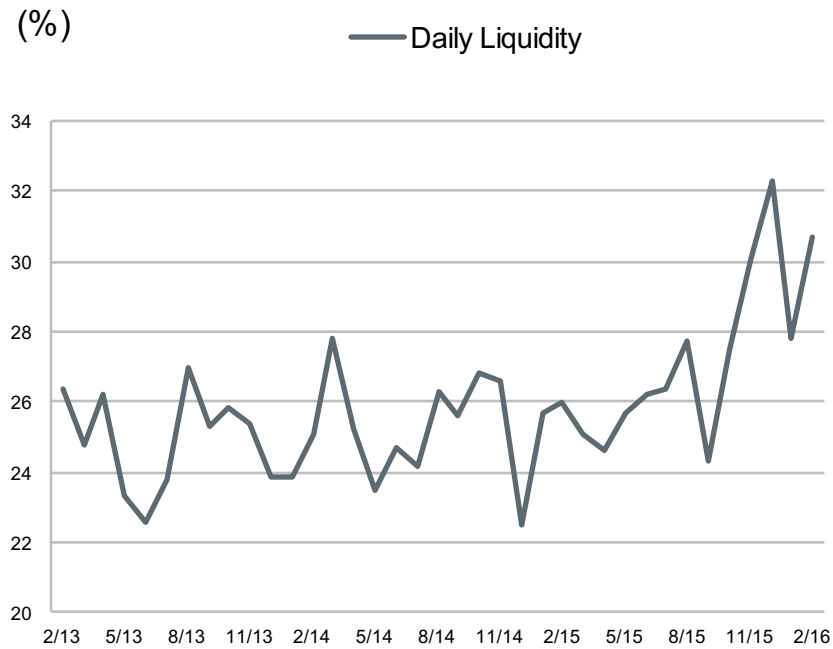




# What You Need to Watch – Fund Liquidity

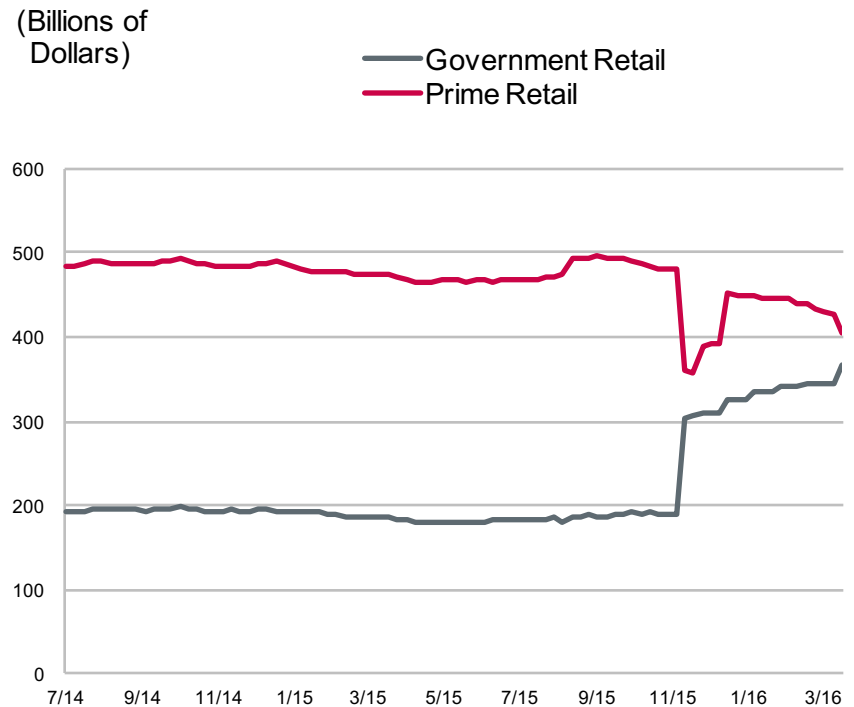
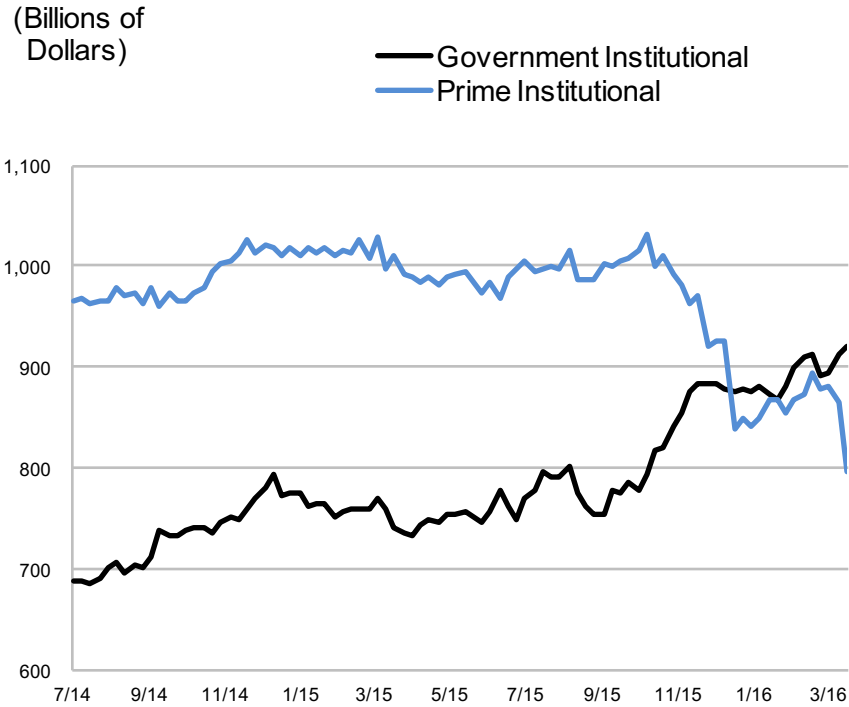


Fitch updated its criteria for money funds on December 10, 2015, anticipating reform-related changes, with a greater focus on money funds' liquidity.



Source: SEC

# What You Need to Watch – U.S. Money Fund Flows



Source: iMoneyNet

# What You Need to Watch – Prime MMF Maturities

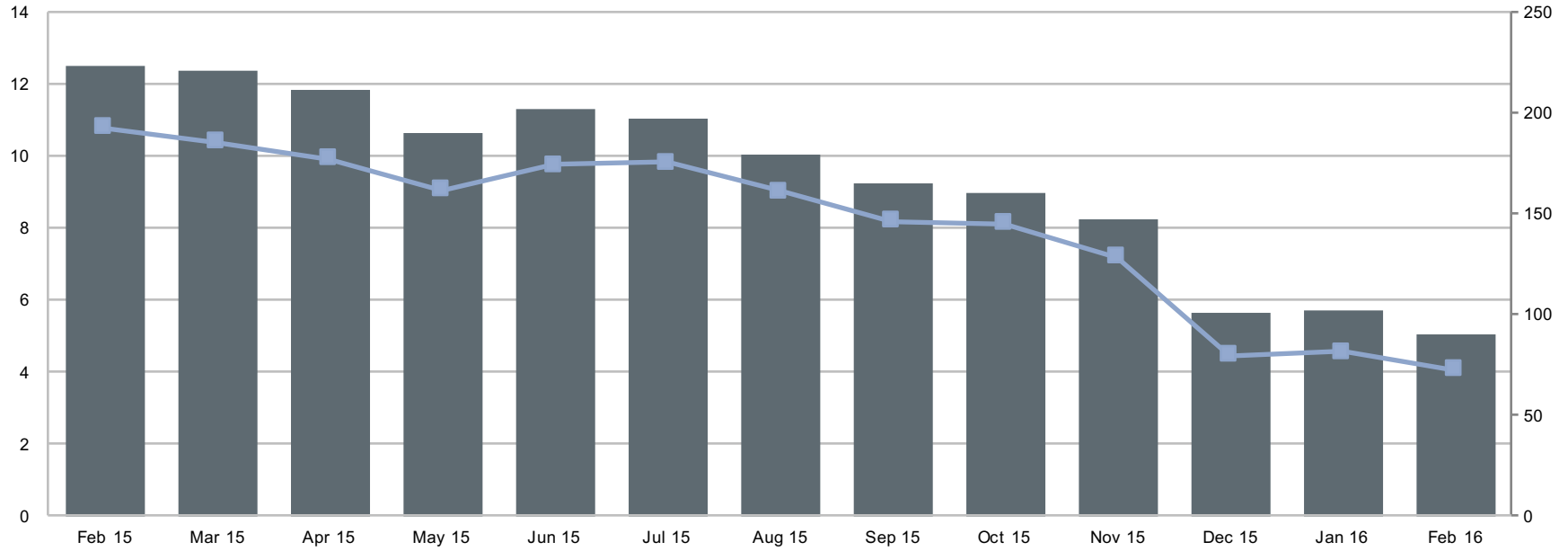


## Prime Money Fund Allocations to Long-Dated Securities (>180 Days) Declining on Reform Caution

% of Portfolio

■ % Allocation (LHS)  
 —■ \$ Allocation (RHS)

(Billions of Dollars)



Source: Fitch, Crane Data



# Money Fund Managers Prepare for MMF Reform



## **Restructuring of existing 2a-7 prime money funds**

- “Short-maturity” funds: investing inside of 60 days or 7 days to limit applicability of floating NAV and/or fees and gates

## **Launching or expanding alternative liquidity products to meet clients’ needs**

- Private/unregistered prime money funds
- Short-term bond funds
- Separately-managed accounts

## **Converting retail prime money funds to government funds to handle “sweep” accounts**

## **Merging funds to reduce costs**

## **Smaller fund managers exiting the industry**

## **Investor outreach**





# How US Money Fund Regulations Impact Corporate Investment Policies



**Final regulations address many of the concerns raised by Treasury Strategies and others during the consultation process with the SEC.**

- Significant recordkeeping relief under new U.S. Treasury/IRS guidance
- Relief from the “wash sale” rule
- Preservation of amortized cost accounting for securities maturing in 60 days or less
- Enhanced tools for fund boards to act in the best interests of fund shareholders

**These four items go a long way toward preserving the investor utility provided by MMFs.**

**This requires careful evaluation of the language in the current investment policy.**

- A stated objective of “preservation of principal” does not necessarily rule out VNAV funds
- More restrictive language such as “a constant net asset value” requirement would necessitate a policy change to permit continued investment
- A stated objective of “daily liquidity” does not necessarily rule out funds subject to fees or gates
- Email [info@TreasuryStrategies.com](mailto:info@TreasuryStrategies.com) for brochure on investment policies with specific suggested language.



As the market evolves, investment guidelines should reflect “best practices” with regard to ratings.

Investment policies that rely on only one or two rating agencies are not reflective of market coverage, and put cash managers at a competitive disadvantage compared to peers.

Barclays’ Capital Aggregate Bond Index requires that an asset should be “**rated investment-grade using the middle rating of Moody’s, S&P, and Fitch Ratings after dropping the highest and lowest available ratings.**”

In short-term markets, the Daily Euro Commercial Paper Index tracks the yield of Euro CP with **A1/P1/F1 ratings.**

**Sample investment guidelines language:** “Investments must be rated A/A/A2 or higher on the long-term scale and/or F-1/A-1/P-1 or higher on the short-term scale by at least two of three said rating agencies (Fitch Ratings, S&P, or Moody’s). Money market funds must be rated equivalent of “AAA” by at least two of three said rating agencies (Fitch Ratings, S&P, or Moody’s).”



## Tools are Changing: Not All MMF Ratings are the Same



Investors in MMFs increase focus on liquidity ahead of October.

Which approach is more aligned with your concerns?

### Fitch AAmmf Ratings Evaluate Liquidity

Money Market Fund ratings (assigned to money market funds and other cash management products) are an opinion on a fund's capacity to fulfill its investment objectives of providing ready liquidity and preserving principal.



### S&P AAAM Ratings do not Address Fees and Gates

"A money market fund rating is a forward-looking opinion about a fixed-income fund's ability to maintain principal value (i.e., stable net asset value and to limit exposure to principal losses due to credit risk. We generally *do not* lower ratings to "Dm" when the manager of any fund suspends redemptions for up to five business days." Additionally, if a fund elects to impose a 2% redemption fee, this is a "credit positive."

**Fitch's MMF rating criteria assesses the same risks as treasurers**



## Conclusion



It is clear that the value proposition of prime MMFs retains its superior position.

Although everyone should review investment policies, it is not clear to us that many will need to be altered.

We strongly recommend that treasurers initiate a dialogue with their CFO or appropriate board committee.

We recommend that treasurers put in place a program to monitor fund ratings, liquidity, and maturities.



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