Blogs
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What Hath FSOC Wrought?

(This post has been updated for October 31st data.) The SEC released its money market fund statistics for the end of October, giving us a comprehensive view of the impact of the reforms which took effect on October 14th. We now have government, retail and floating NAV money market funds, the later two with the potential for liquidity fees and redemption gates. The Wall Street Journal has run a number of stories about the "unintended" consequences of the reforms. The impact on the funds has been entirely consistent with the comments the SEC received on the proposed reforms--so this outcome should have been expected. By the time the dust fully settles, FSOC may have momentarily succeeded in its objective of reducing the assets of prime money market funds to a level where they cannot pose a threat to the stability of the financial system, assuming they ever did.

The Fall Out

The trends since the reforms were adopted in July 2014 are indisputable. First, as shown below, the number of funds has fallen markedly since July 2014. This is a continuation of a trend that predates the reforms: there were over 600 funds in October 2012. Near zero interest rates and the resulting near zero fees probably explains much of the decline. But the funds were liquidated or merged away at a faster pace after the Fed increased rates at the end of 2015, so this cannot be the whole story. 1 number of funds As the next chart shows, assets (in billions) have moved from prime funds into government funds. Some of this move reflects sponsors converting institutional prime funds (which are burdened with floating NAVs as well as potential fees and gates) into government funds (which have none of these burdens). But this was mostly completed early in 2016, and the rate of change only increased after that. 2 pime govt tax The scale of the second chart obscures the impact of the reforms on tax exempt funds. The final chart shows the assets in each category of funds as a percentage of June 30, 2014 assets. Tax exempt fund assets have generally fallen in parallel with the decline in prime fund assets. Tax-exempt funds have lost half their assets, and prime fund assets are down by two-thirds. 3 prime percent

Systemic Impact?

To put these numbers in context, the percentage decline in prime fund assets last September (28%) was larger than the percentage decline in assets during September 2008 (24%). And rather than rebounding in October, prime fund assets fell another 24%. As predicted, the reforms resulted in a larger and more extended run on the prime funds than the Reserve Primary Fund breaking dollar. Yet the run did not produce a systemic impact. How could that be? The final chart shows the amount of commercial paper outstanding (as reported by the Federal Reserve) during the eight months ending October 31 (the period readily available at the Fed website), and the amount of CP held by the prime money market funds (as reported by the SEC). (Prime fund holdings are somewhat overstated, as the SEC data includes all nonfinancial company obligations.) 4 cp Although prime fund holdings of CP are down by $400 billion, outstanding CP has declined by only $185 billion. Someone has stepped in to provide over $200 billion of funding to this market. Is there any reason to believe these new investors will be less likely to bolt from the CP market during the next financial crisis? If not, did the reforms do anything to reduce systemic risks?

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