Blogs
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Asset Management ADVocate

Money Market Fund Reforms Three Years On

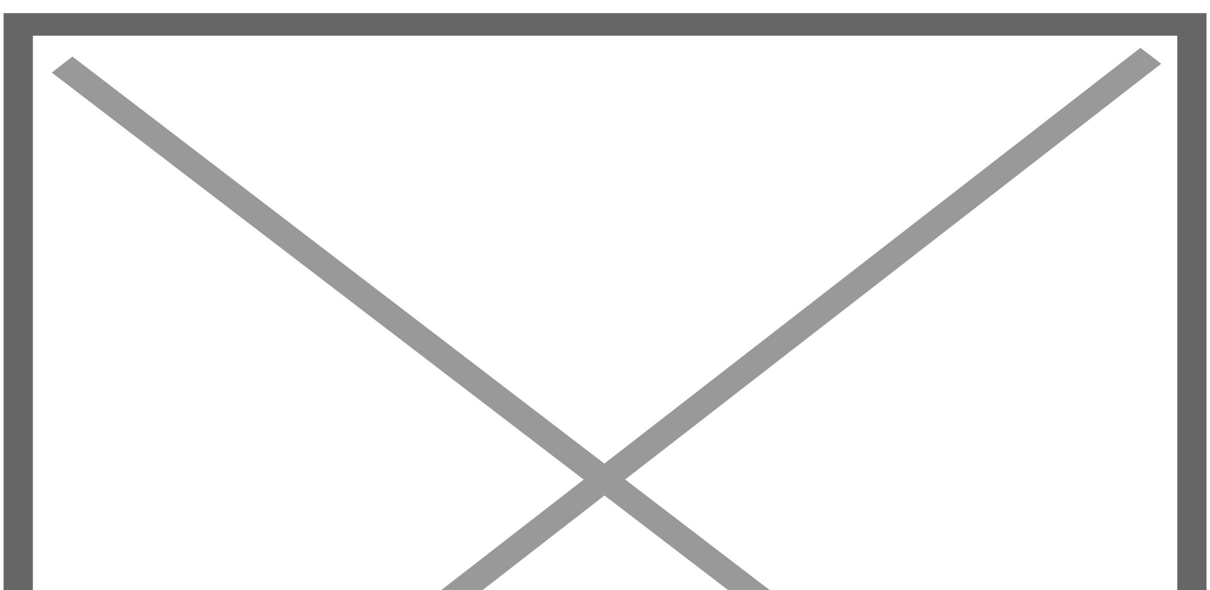
The convergence of several events makes this an appropriate time to reassess the impact of the SEC's 2014 money market fund reforms (the "Reforms"). First, the SEC has released official money market fund ("money fund") statistics for October 2019, three years after the effective date of the Reforms. Second, total money fund assets are very near $4 trillion, just over $1 trillion higher than they were before the SEC adopted the reforms in July 2014. Third, prime money fund assets are back over $1 trillion. Finally, former Fed Chairman Volcker, an implacable opponent of money funds, recently passed away. Money funds have demonstrated remarkable resilience in the face of zero interest rates, FSOC activism, and Chairman Volcker's critiques. What else might we discern from the post-Reform state of money funds.

Still on the Job

Competing with banks for cash balances is, in my opinion, the primary justification for money funds. Historically, banks have sought to avoid paying interest on retail deposits. By providing access to wholesale funding rates paid on commercial paper, negotiable CDs and repurchase agreements, money funds pressure banks to pay interest to retail depositors. This competition can make the Fed's job harder, which is one reason for Chairman Volcker's aversion to money funds. Several banks and brokers used the Reforms and coincident near zero interest rates as an opportunity to switch their sweep options to bank accounts. Interest on these accounts did not keep pace with the Fed's earlier rate hikes. Recently, Fidelity and Vanguard have made the higher rates paid on the money fund sweeps a point of emphasis in their marketing. One can hope that this will encourage banks and brokers to increase the rates paid on their sweep options.

Fewer Funds; More Concentration

Three hundred seventy-two money funds were reported at October 31, 2019, 48 fewer than at October 31, 2016, and almost exactly two-thirds the number of funds reported at June 30, 2014, the month-end before the SEC adopted the Reforms. The number will fall farther in November as a result of Federated Investors' acquisition of the PNC money funds. New money fund launches are rare occurrences. Many of the funds have been acquired by large cash managers, such as Federated and Blackrock, increasing the concentration of an already concentrated sector.



Government Money Funds: Continued Dominance

The $1.2 trillion of assets that flowed from prime to government money funds as a result of the Reforms has stuck. In the three years since October 31, 2016, government money fund assets have grown another $475 billion. The rate of growth of government money funds has outpaced the growth of prime money funds during the past twelve months. While it would be tempting to blame recent problems in the repo market on the Reforms, the inability of government money funds to meet funding demands appears more symptomatic than etiological.

Prime Money Funds: Back in the Fight

Prime money fund assets have grown by $540 billion in the three years since October 31, 2016, nearly doubling. Over the same period, their share of commercial paper funding has increased to 40% from 25%. While assets and share of commercial paper funding has increased steadily over the past twelve months, it seems unlikely that prime funds will regain their pre-Reform two-thirds share of CP funding in the near term, if ever. This is probably for the best; more diversity in funding sources should make the money markets more resilient.

Tax Exempt Money Funds: The Casualty of the Reforms

Unlike prime money funds, tax exempt funds have not recovered the assets lost to the Reforms. October 31, 2019, assets were just over $140 billion, about 46% below the level on June 30, 2014. The Reforms deprived municipalities of a substantial source of reliable funding with no corresponding increase in investor protection. Persistent low interest rates have no doubt contributed to the tax exempt funds' moribund response to the Reforms. When a handful of basis points are all that separate taxable and tax exempt rates, municipalities don't feel as much pain when forced to borrow from banks at higher rates and investors don't find the tax benefits as alluring. Reductions in the top tax brackets have further diminished the attraction of tax exempt money funds as an investment. If they can hang on, tax exempt money funds may enjoy a fuller recovery in the future, when interest and tax rates begin their inevitable increase. But I have no idea when this will be.

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