Money Market Strategies: White Paper

New rules from the Securities and Exchange Commission (SEC) regarding money fund regulations represent a dramatic overhaul for the liquidity management industry, which has relied upon stable net asset values (NAV) money funds for decades, according to a new Fitch Ratings special report.

On July 24, 2016 the Securities and Exchange Commission (SEC) voted to adopt rule changes to money fund regulations under rule 2a-7 of the Investment Company Act of 1940 (Rule 2a-7). Under the new rules, institutional prime and municipal money funds are required to float their NAVs. Prime and municipal retail money funds, as well as all government money funds, will continue to transact at a stable $1.00 NAV.

In addition, both retail and institutional prime and municipal funds could adopt liquidity fees and gates during periods of market stress. For these funds, if weekly liquid assets fall below 30% of the total, the funds' boards of directors have the option of imposing liquidity fees of up to 2% on any redemptions, or gate the fund and block redemptions altogether for a period. If weekly liquid assets fall below 10%, boards will be required to impose a 1% liquidity fee, unless they determine it is not in the best interest of shareholders. Retail and institutional government money funds are exempt from these requirements, although they can voluntarily opt in.

According to the Fitch report, the operational changes necessary to continue using institutional prime and municipal money funds will likely prove too burdensome for many users of NAV-money funds, which are heavily represented by corporate and public sector cash managers. In surveys conducted by both Treasury Strategies and the Association for Financial Professionals, a majority of cash investors who use money funds have indicated that they will stop using, or reduce usage, of money funds with a floating NAV.

Many investors in institutional prime and municipal money funds are expected to move cash into government money funds exempt from the new rules, and/or bank deposits, assuming there is capacity to absorb the inflows. Corporate and public sector cash managers will likely also explore alternative liquidity management options like separately managed accounts, or increase their direct investments in the short-term markets.

Many institutional investors will need to re-examine and update their written investment policies to be able to use the new money fund structures or access alternative liquidity management solutions, according to Fitch. For example, some policies specifically dictate that money funds must have a stable NAV, and corporations and municipalities will have to determine whether they would be comfortable investing cash in a floating NAV fund. In addition, fund managers are expected to introduce new liquidity products, but these may need to be added as approved investments to treasurers' policies.

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