

Money Fund Report®

Friday, September 24, 2010

LEADING THE INDUSTRY IN MONEY FUND NEWS

#1815

◆ LIQUIDITY BANK IDEA TAKES HOLD

“What’s really necessary to further enhance the resilience of money funds is the adoption of the liquidity bank,” stated J. Christopher Donahue, president and chief executive officer at Federated Investors.

Donahue, speaking recently at Barclays Capital’s 2010 Global Financial Services Conference, explained that it is a “very simple” idea. “You create a trust company or a bank that is then funded by two different things; contributions by investment advisers who own commercial paper money funds and by the commercial paper funds themselves. This capital builds up and is used for the purpose of taking care of liquidity problems. Notice I didn’t say credit. This is a liquidity-bank solution. At the end of the day, the liquidity bank has access to the Fed, and this was what really solved the problem in the money fund industry in the late September ’08 time frame. So we think it is an excellent idea whose time has come.”

Niels Holch, executive director of The Coalition of Mutual Fund Investors, interviewed by *MFR*, agreed with Donahue that it is both a “simple” and “good idea.”

“I just think this liquidity bank is a good extra step for investor confidence,” Holch said. “Investors are used to putting their money into banks where there’s an FDIC guarantee. I think it’s nice to talk about internal liquidity standards, but most investors don’t understand all that stuff, and they are not going to read SEC regulations about money-market funds. So it’s a really good move, both substantively and from a public relations point of view, to have a facility like this so you can say to investors that this backstop is out there and could be used in the case of a crisis.”

The Investment Company Institute has been working on a “blueprint for such a liquidity facility,” according to President Paul Schott Stevens. “This would be a state-chartered bank or

trust company, organized and capitalized by the prime money-market fund industry and managed and governed in accordance with applicable banking laws. It would be dedicated to providing additional liquidity to prime money-market funds in the event of severe market conditions.”

The U.S. Treasury Department in June 2009 issued a white paper called “Financial Regulatory Reform: A New Foundation” in which the ideas of a liquidity facility and a floating net asset value for money funds were raised as ways to “further reduce the MMF industry’s susceptibility to runs.”

The idea of a floating net asset value met a swift and negative response, while the idea of a liquidity facility was met with unanimous support from large money-market fund providers.

BlackRock Favors Accounting-Rule Change

In a recent publication making a case against floating-NAV MMFs, BlackRock also called for a change in FASB rules which would make it easier for funds to “create a rainy day fund.” Fidelity and Vanguard, meanwhile, declined to comment on their respective strategies. Bloomberg.com reported about one year ago that the respective firms were among those with plans “to set up an emergency pool of cash” to prevent a run. Holch believes most firms have cash set aside in-house.

While the ICI continues its work on the liquidity-bank proposal, more rulemakings and recommendations by the Securities and Exchange Commission and the President’s Working Group loom. “The PWG is focused on systemic risk,” Holch noted. “Obviously a number of money-market funds were under pressure. So this is a systemic-risk issue and not simply an SEC issue. I suspect they would coordinate with the PWG in the next round of rulemaking.”◆

◆ S&P SEEKS FEEDBACK ON PROPOSED CRITERIA CHANGE

Standard & Poor’s is seeking feedback on the idea of changing the way the rating agency evaluates counterparty risk for funds carrying its principal stability fund ratings and fund credit quality ratings.

Its Sept. 17 Request for Comment focused on “proposed fund criteria revisions (which) apply to all global funds with PSFRs and FCQRs.”

S&P cited counterparty transactions that include repos, reverse-repurchase agreements, swaps, forward purchases, foreign-exchange contracts and other hedging positions. “Specifically, when evaluating funds with PSFRs and FCQRs, we propose that counterparties (e.g., broker/dealers) that do not have an explicit or counterparty credit rating from S&P, and do not have a guarantee of their obligations from an S&P-rated entity, will be viewed as having high credit risk.”

S&P asks participants to reply to two questions: “Do you believe that unrated counterparties pose potentially significant credit risk to highly-rated funds that have a PSFR or FCQR?” And, second, “Does your opinion change if the unrated counterparty is 50 percent or more owned by a rated parent?”

The apparent move to adjust the credit-rating methodology was prompted by what S&P described as the “significant turbulence and dislocation in the banking sector during the past few years.”

“We believe it is important to understand a subsidiary’s stand-alone credit profile, the strategic significance of the subsidiary to the group, and the parent’s ultimate willingness to provide

extraordinary support if needed. Given this uncertainty, we are proposing that repos and other obligations from unrated counterparties be viewed as high-risk assets.”

The rating agency said that, when it comes to PSFRs, it will “likely” assess the credit risk of obligations from unrated counterparties as not investment-grade. They will likely be treated as “CCC-equivalent.”

The response deadline is Oct. 5. Once the comment period is over, S&P plans to review the responses and then publish “comprehensively-updated criteria.”◆

MFR COMMENTARY

Net assets of 1,145 Taxable MMFs fell \$34.88 billion to \$2.444 trillion as of Sept. 21. Taxable Institutional funds experienced an outflow of \$22.66 billion; Taxable Retail funds had an outflow of \$12.23 billion.

The iMoneyNet Money Fund Average™/All Taxable 7-Day Yield remained at 0.04 percent for the 14th consecutive week. The All Taxable 30-Day Yield remained at 0.04 percent for a 13th straight week. The WAM lengthened to 45 days from 44 days the previous week.

Assets of the 492 Tax-Free and Municipal MMFs experienced an outflow of \$2.71 billion, lowering the total to \$334.36 billion as of Sept. 20.

The iMoneyNet Money Fund Average™/All Tax-Free 7-Day Yield rose to 0.04 percent from 0.03 percent the week before. The All Tax-Free 30-Day Yield has held at 0.04 percent for 22 weeks. The WAM lengthened to 33 days from 32 days the previous week.

Total net assets of 1,637 Taxable and Tax-Free money funds decreased \$37.60 billion, lowering the grand total to \$2.778 trillion.

Money Fund Report

SUMMARY OF MONEY FUND ACTIVITY

Period Ending: 9/21/10 — Taxable Funds • 9/20/10 — Tax-Free Funds

# of Money Funds	Net Assets (\$Mils)	1-Week Change		7-Day Yield (%)	30-Day Yield (%)	Compound 7-Day Yield (%)	Compound 30-Day Yield (%)	12-Month Yield (%) (8/09)	Average Maturity (Days)
Taxable Money Funds									
33	62,104.3	-364.4	Treasury Retail	0.01	0.01	0.01	0.01	0.02	53
33	62,468.7			0.01	0.01	0.01	0.01		53
43	18,566.9	-151.6	Treas & Repo Retail	0.01	0.01	0.01	0.01	0.01	32
43	18,718.5			0.01	0.01	0.01	0.01		30
120	110,443.3	-609.2	Govt & Agency Retail	0.02	0.02	0.02	0.02	0.02	44
120	111,052.5			0.02	0.02	0.02	0.02		43
196	191,114.5	-1,125.2	Government Retail	0.01	0.02	0.01	0.02	0.02	46
196	192,239.7			0.02	0.02	0.02	0.02		45
329	561,592.6	-11,099.8	First Tier Retail	0.02	0.02	0.02	0.02	0.03	46
329	572,692.4			0.02	0.02	0.02	0.02		46
329	561,592.6	-11,099.8	Prime Retail	0.02	0.02	0.02	0.02	0.03	46
329	572,692.4			0.02	0.02	0.02	0.02		46
525	752,707.1	-12,225.0	Taxable Retail	0.02	0.02	0.02	0.02	0.02	46
525	764,932.1			0.02	0.02	0.02	0.02		45
329	628,262.2	-11,407.0	Government Institutional	0.02	0.02	0.02	0.02	0.02	45
329	639,669.2			0.02	0.02	0.02	0.02		44
291	1,062,818.0	-11,252.1	First Tier Inst	0.10	0.10	0.10	0.10	0.09	44
291	1,074,070.1			0.10	0.11	0.10	0.11		44
291	1,062,818.0	-11,252.1	Prime Institutional	0.10	0.10	0.10	0.10	0.09	44
291	1,074,070.1			0.10	0.11	0.10	0.11		44
620	1,691,080.2	-22,659.1	Taxable Institutional	0.06	0.06	0.06	0.06	0.05	44
620	1,713,739.3			0.06	0.06	0.06	0.06		44
1145	2,443,787.3	-34,884.1	Taxable (All)						
1145	2,478,671.4								
iMoneyNet MONEY FUND AVERAGE™/Taxable (All)				0.04	0.04	0.04	0.04	0.04	45
PriorWeek's Averages				0.04	0.04	0.04	0.04		44
Tax-Free Money Funds									
104	123,680.4	-1,982.8	Tax-Free National Retail	0.03	0.03	0.03	0.03	0.03	31
104	125,663.2			0.02	0.03	0.02	0.03		30
126	117,328.9	172.1	Tax-Free National Inst	0.06	0.06	0.06	0.06	0.07	34
126	117,156.8			0.06	0.06	0.06	0.06		33
156	77,042.3	-595.2	Tax-Free State Retail	0.02	0.02	0.02	0.02	0.02	34
156	77,637.5			0.02	0.02	0.02	0.02		33
106	16,304.0	-308.7	Tax-Free State Inst	0.04	0.04	0.04	0.04	0.04	32
106	16,612.7			0.03	0.04	0.03	0.04		32
492	334,355.6	-2,714.6	Tax-Free (All)						
492	337,070.2								
iMoneyNet MONEY FUND AVERAGE™/Tax-Free (All)				0.04	0.04	0.04	0.04	0.04	33
PriorWeek's Averages				0.03	0.04	0.03	0.04		32
1637	2,778,142.9	-37,598.7	Grand Total - MMFs (All)						
1637	2,815,741.6								

Reproduction in any form without written permission is strictly forbidden.

7- and 30-day yields represent annualized results for the periods, net of management fees and expenses. 12-month yields assume reinvestment of dividends for up to one year. Money Fund Report® Compound Averages follow the calculation method approved by the SEC:

$$\text{compound average} = \left(\left\{ 1 + \frac{\text{7-day average yield}}{(100 \times 52.142857)} \right\}^{52.142857} - 1 \right) * 100$$