US Rates Watch

SEC MMF reform: steps forward this week

10 July 2023

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MMF = money market mutual funds

SMAs = separately managed accts

SEC to consider money fund rule amendments this week

Last week the SEC announced an open meeting to consider money market mutual fund rules. Specifically, the SEC open meeting agenda will consider: "whether to adopt amendments to certain rules that govern money market funds and related form amendments". The meeting will take place on July 12 at 10 AM.

Recall, the SEC proposed amendments to rules that governed money market funds in late '21. The proposed amendments would (1) remove liquidity fees and redemption gates (2) convert stable NAVs to floating in certain circumstances (3) implement swing pricing (4) increase liquidity requirements, and (5) enhance MMF regulatory reporting. For detail see Exhibit 1 & prior writings: US money fund reform & Final rule due soon.

Industry responses suggest strong support for some & strong opposition to other SEC amendments. Public comment letters have been largely supportive of removing liquidity fees / redemption gates & increased liquidity requirements. Commentors have been largely opposed to swing pricing & floating NAVs in certain circumstances.

Rules under consideration are unclear

It is unclear which rules the SEC will consider this week. The SEC has not provided any clarity or guidance on which rules will be open for discussion. The SEC could opt to advance the rules with widespread support or may consider all proposals at this meeting. The industry will likely be kept guessing until Wednesday. We believe the long delay in SEC rule consideration likely reflects Commissioner disagreement on some amendments.

Swing pricing: prime outflows & credit cheapening

We believe swing pricing will be the most impactful if adopted. Recall, swing pricing would essentially function as a liquidity fee; it would adjust fund NAV such that costs imposed by large net redemptions are passed on to the redeeming shareholder.

Swing pricing adoption would likely see (1) sizeable prime MMF outflows & reduced MMF demand for CP / CDs (2) reallocation out of prime into gov't MMF & more demand for bills, agency debt, & repo. We previously estimated the impact of 3m L-OIS wider by 3-7bps. We refresh our analysis on page 2 which reinforces our prior estimates.

Our analysis makes 2 key assumptions: (1) prime outflows will be larger for institutional funds, which are impacted by swing pricing (2) 50% of any prime outflows will move to gov't MMF & 50% will move to SMAs / short duration funds. The shift to SMAs / short duration matters b/c these funds will likely invest a similar asset proportion in CP / CDs. The impact will not be realized until implementation, which could take years.

Bottom line: SEC will consider MMF rule amendments this week. Swing pricing is likely the most impactful amendment. It could result in sizable prime institutional MMF outflows, modestly cheapen credit, & increase demand for bills, agency debt, & repo.

Swing pricing impact: 3-7bps credit cheapening impact

In assessing the MMF outflow & market impact, we start with MMF reform in 2016. This reform period saw prime institutional MMF outflows of 60-85% depending on period ($500-680b) & prime retail MMF saw outflows of 37-43% ($165-190b) (Exhibit 2). We assume a similar & larger impact on prime institutional MMF today, which could amount to outflows in prime inst of $400-$550b & prime retail of $200-230b (Exhibit 3).

Prime MMF CP / CD holdings as a % of total assets are somewhat smaller today to '16 (Exhibit 4, Exhibit 5). The impact of prime outflows on credit should thus be smaller vs '16. According to Fed Z1 data in the 1Y prior to '16 reform prime CP & CD / AUM was ~60% vs 45% today. Prime MMF today hold ~25% less CP & CD to total assets vs '16.

We assume prime MMF outflows will move roughly 50 / 50 into gov't MMF & SMAs / short duration funds. This is a very rough estimate but many of our MMF contacts believe it is a reasonable at present. The shift to SMAs / short duration matters b/c these funds will likely invest a similar proportion of inflows in CP / CDs.

During the period of '16 prime MMF outflows 3m LIBOR-OIS widened 11-19bps. Although LIBOR no longer exists this historic data provides a guide to the potential credit impact today.

Putting all this together, we believe that a 3m LIBOR-OIS equivalent today would widen 3-7bps due to swing pricing & prime outflows (Exhibit 6). We might guess the impact could be slightly larger given strong prime MMF AUM growth over recent quarters (Exhibit 7). To arrive at our 3-7bps estimate we calculate: (prime MMF outflows due to swing pricing / prime MMF outflows in '16) * (3m LIBOR-OIS impact in '16) * (relative change in CP & CD / prime MMF AUM) * (50% for SMA / short duration inflows).

We acknowledge the potential prime MMF outflow size & impact are very uncertain. We judge risks are likely skewed to the upside on the outflow size & market impact.

Exhibit 1: SEC MMF reform proposals
The SEC has proposed 5 changes to MMFs

#	Reform	Description	Funds impacted
1	Removal of tie between MMF Liquidity and Fee/Gate	Funds can impose fees/gates when in the best interest of fund, not at specific level	All prime and tax-exempt MMFs
2	Floating NAVs	Stable NAV funds must convert to a floating share price if future market conditions result in negative fund yields (i.e. Fed implements negative rate policy)	All MMFs, institutional prime and tax-exempt MMFs are already subject to the rule
3	Swing Pricing Requirement	Adjust NAV downward when redemptions exceed a threshold. This imposes costs on redeeming investors	Institutional prime and tax-exempt MMFs
4	Higher daily and weekly liquid asset requirements	Increase daily and weekly liquid asset requirements to 25% and 50%, respectively	All MMFs; tax-exempt MMFs are only subject to a weekly requirement
5	Amend reporting requirements	Amend certain reporting requirements to improve the availability of information about MMFs and enhance the Commission's monitoring & analysis of these funds	All MMFs

Source: BofA Global Research, SEC

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Exhibit 2: 2016 reform MMF outflows by type ($bn) & 3m LIBOR-OIS impact (bps)

Prime & tax exempt institutional funds saw largest outflows while gov't MMF saw large inflows

	Prime Inst: ICI	Prime Retail: ICI	Tax Exempt Inst: ICI	Tax Exempt Retail: ICI	Gov't Inst: ICI	Gov't Retail: ICI	3m LIBOR-OIS (bps)
AUM $bn							
End Mar '16	803.7	443.5	57.4	170.0	910.1	380.8	23.1
End Sep '16	304.1	278.8	24.2	107.4	1427.4	538.5	42.5
End Dec '16	124.0	252.4	4.4	126.6	1617.7	604.3	34.1
$ Change							
Mar - Sep '16	-499.6	-164.7	-33.2	-62.6	517.3	157.7	19.4
Mar - Dec '16	-679.8	-191.1	-52.9	-43.5	707.6	223.4	11.0
% Change							
Mar - Sep '16	-62%	-37%	-58%	-37%	57%	41%	
Mar - Dec '16	-85%	-43%	-92%	-26%	78%	59%	

Source: BofA Global Research, Bloomberg

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Exhibit 3: Projection for potential prime & tax exempt MMF outflow based on 2016 reform ($bn)

Prime institutional MMF could see outflows of $400-550b while prime retail could see $200-230b

	Prime Inst: OFR	Prime Retail: OFR	Tax Exempt Inst: OFR	Tax Exempt Retail: OFR
AUM End May '23	653.1	535.9	14.7	103.9
Projection using: Mar-Sep '16 outflow	-406.0	-199.0	-8.5	-38.3
Projection using: Mar-Dec '16 outflow	-552.4	-230.9	-13.6	-26.6

Source: BofA Global Research, Office of Financial Research

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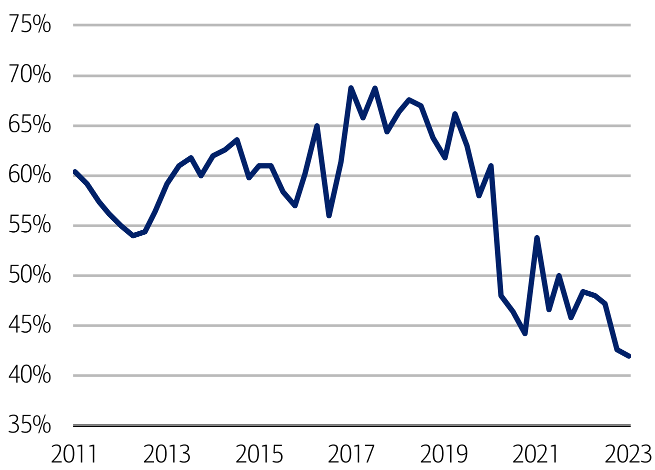
Exhibit 4: Prime MMF CP & CD as % of total AUM

Prime MMF have reduced their CP & CD holdings in recent years



Source: BofA Global Research, Fed Flow of Funds

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Exhibit 5: Prime MMF CP & CD holdings at end May '23 ($bn)

Prime MMF hold around 35-40% of AUM in CP & CD

	Prime Inst	Prime Retail
CD	77	96
CP	137	119
Fin CP	86	83
Non-Fin CP	34	29
ABCP	17	6
Total CP & CD	214	215
Asset Total	637	538
CP & CD %	34%	40%

Source: Crane Data

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Exhibit 6: Credit impact calculation based on 3m LIBOR-OIS change in 2016

3m LIBOR-OIS would be expected to widen 3-7bps today

	Prime Inst	Prime Retail	Total	3m L-OIS Change
Historic				
Mar - Sep '16	-499.6	-164.7	-664.3	19.4
Mar - Dec '16	-679.8	-191.1	-870.9	11.0
Projected				
Mar - Sep '16	-406.0	-199.0	-605.0	17.6
Mar - Dec '16	-552.4	-230.9	-783.3	9.9
Adjustment for 50% SMA inflow & 25% lower credit / prime AUM allocation				
Projection over historic periods				
Mar - Sep '16				6.6
Mar - Dec '16				3.7

Source: BofA Global Research

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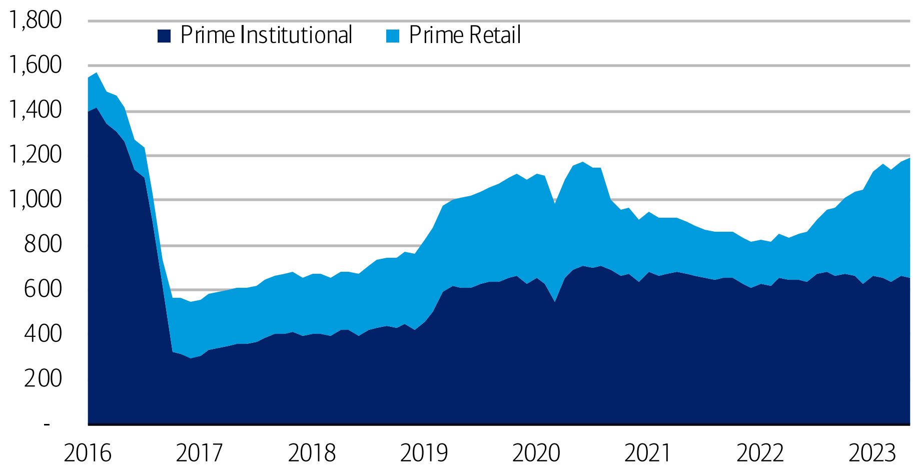
Exhibit 7: Prime MMF AUM ($bn)

Prime inflows have increased with higher rates, especially into prime retail



Source: Office of Financial Research

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