After Reforms, U.S. Prime Money Funds Grow Despite Spread Compression

A year after reforms caused over $1 trillion to flee the space, U.S. prime money funds continue to show slow but steady growth — even as spreads between prime and government fund yields narrowed from their March 2017 highs. Net yield spreads between prime and government funds fell to 0.26% in September from 0.33% in March but Fitch Ratings expects growth to continue despite investor concerns about NAV stability and fees/gates and the small size of many funds. On Sept. 29, prime fund assets were $440 billion, up 19% over last November.

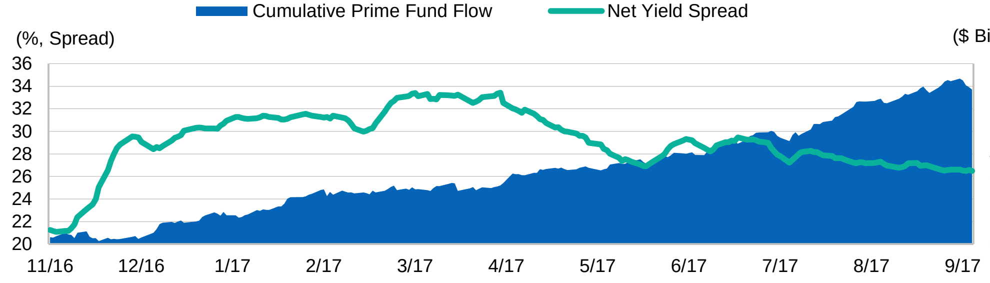
The return to prime funds contrasts with some other gauges of investor sentiment. In a recent AFP survey, 43% of investors said they would require a yield spread greater than 0.50% to consider returning to the funds, while another 40% said no amount of spread would justify a return to prime funds given their new features.

The post-reform exodus was largely due to investor concerns over access to liquidity and principal preservation caused by new fees and gates, as well as worries about principal preservation due to floating-rate NAV rules. Nonetheless, fund managers have demonstrated their ability to manage the funds in the post-reform environment.

Institutional prime funds have exhibited NAV stability since moving to a floating NAV, which should partly mitigate investors' principal preservation concerns. Since the reforms, 96% of observations of daily changes in institutional prime fund NAVs have shown no movement and 4% showed NAV moved up or down by 1 basis point (bp). In a few cases NAV moved by 3 bps or more in one day.

Fund managers continue to employ conservative liquidity management strategies, maintaining weekly liquidity buffers above the 30% regulatory threshold to assuage investor concerns about the liquidity fees and redemption gates features. Of 30 institutional prime funds reviewed, average weekly liquidity over a recent 30-day period was approximately 50%, although funds' weekly liquidity targets vary depending on their investor base, as shown by the chart on the bottom right.

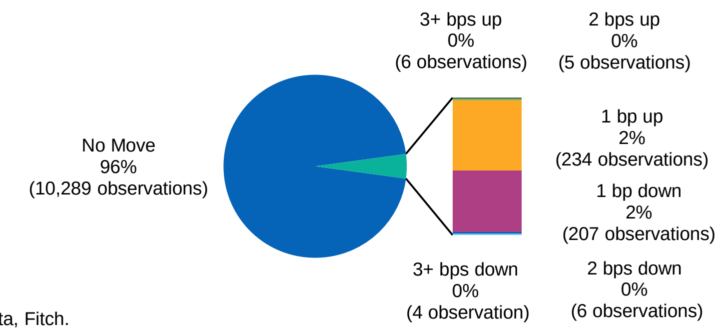
Prime Fund Assets Growing as Net Spreads between Prime and Government Money Funds Declined



Source: iMoneyNet, Fitch.

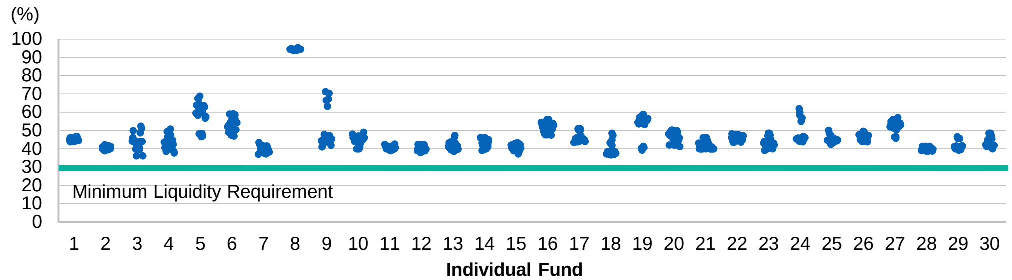
Daily Changes in Institutional Prime Money Market Fund NAVs Post-Reform Through Early October

(No. and % of Observations Across 38 Funds Since October 14, 2016)



Source: Crane Data, Fitch.

Distribution of Weekly Liquidity Across 30 Prime Institutional Funds — Over Recent 30 Days Period



Note: Data from August 22, 2017 to October 3, 2017.
Source: CraneData, Fitch.

Ralph Aurora
+1 212 908-0528
ralph.aurora@fitchratings.com

Greg Fayvilevich
+1 212 908-8151
gregory.fayvilevich@fitchratings.com