TREASURY, RISK AND FINANCE PROFESSIONALS ACT

The Association of Corporate Treasurers

Comments in response to
Proposed recommendations regarding money market mutual fund reform
Issued by the Financial Stability Oversight Council
November 2012

15th February, 2013

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. We are based in the UK but have members across the globe. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer magazine*, topic-specific working groups and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter.

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We understand the concerns of the FSOC that Money Market Funds (MMFs) have the potential to be vulnerable to runs and, through their significant role in funding governments and financial institutions, transmit this into a destabilising effect on the wider financial systems. However we believe that the current proposals are disproportionate to the risks, particularly since the SEC 2010 reforms have already made the funds more resilient by improving their liquidity standards.

In your economic assessment you imply that investors will continue to use MMFs even if changed into the new structures. Our members, who tend to work for non-financial companies, are major users of MMFs and if any of your proposals are implemented significant numbers of companies will cease to invest in affected funds. Surveys on both sides of the Atlantic suggest that some 70% to 80% of these non financial investors will

move funds away. As an alternative companies may place deposits directly with a few financial institutions creating an increased risk within the corporate sector due to the reduced diversification as the wide portfolio of an MMF is not accessed. Companies will address this by regarding bank deposits as hot money prone to be withdrawn at the slightest rumour. You will be creating a particularly flighty form of short term finance for financial institutions and others.

As some reduction in risk, some companies will start to make secured deposits with banks (repos) and we issued a briefing note on this last year. We understand that repos raise their own financial stability issues.

Specific Comments

Floating Net Asset Value

Non-financial companies investing in MMFs regard these investments as cash or cash equivalents in economic as well as accounting terms. They are seeking a safe return and their objectives are sometimes summarised with the acronym SLY – they seek Security, Liquidity and Yield in that order of priority. Maintaining a constant NAV is therefore of prime importance, so much so that our members would, in the main, not be allowed by their company treasury policies to invest in an MMF with a variable NAV.

At this point we should add that as a professional body we flag to our members that even with a constant NAV there is no absolute guarantee that the funds will not suffer a loss. If a CNAV fund converts to VNAV but has exactly the same investment policies then there is an apparent logical flaw if investors use that as a reason not to invest. The logic can only be justified it is believed that the CNAV label imposes a stronger investment management discipline on the fund managers. We note that some CNAV funds are starting to publish their actual NAV daily which could, over time, help investors become comfortable with the VNAV concept.

The other very strong driver that makes CNAV funds attractive is that they can be accounted for as cash equivalents. Both IAS 7.6 and FASB codification 310-20 include in their definitions of cash equivalents that they are short term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value. It would be very helpful if the IASB and FASB were to provide additional guidance on the categorisation of a VNAV fund that was operating under the constraints of Rule2a-7 with the policy objective of maintaining the NAV within say 50bp of par (as in the IMMFA Code). We recommend that the FSOC use its good offices to seek such a clarification.

Net debt, namely gross debt after netting off cash and cash equivalents is widely used in financial analysis and is regarded as a key indicator, often included in contractual covenants[1]. Therefore for non-financial companies the treatment of a MMF investment as cash equivalents is absolutely critical to the decision to invest or not invest.

[1] It is open to the parties to include short term investments in the netting off. However the mind set of banks is largely fixed by the accounting presentation and only the largest high credit standing companies can overcome this mistake.

NAV buffers and minimum balance at risk or other measures

Alternatives two and three in your paper would create an instrument with very different characteristics as compared to current MMFs. The protections, and incentives not to rush to redeem, are well crafted and would create something that might be regarded as attractive by some investors seeking a safer investment but with impaired liquidity characteristics. However for companies seeking a straightforward cash equivalent investment the buffers and holdbacks would make the instrument unacceptable.

Your economic analysis assumes that the cost of funding the equity buffer is passed on to the institutions with whom the MMF invests. Alternatively the yield to the MMF investors will be reduced. If this is the case we do wonder if the instrument will remain attractive even to those investors prepared to accept the risk of holdbacks. Based on feedback from our members a fund with CNAV but with the features of buffers and holdbacks would quite simply not be used. Your economic assessment of the proposed changes should factor in as a possibility a much reduced flow of funds through MMFs to finance financial institutions and others.

If non-financial companies find that the new structures for MMFs are no longer suitable the alternatives available to them will include separately managed accounts, directly invested term deposits and secured deposits (repos). Companies will lose the benefits of diversification, the cost efficiencies and the instant liquidity and will take on a more concentrated credit risk. To help manage this changed position companies may keep their deposits very short term and they will be very sensitive to credit deterioration. The influence of the credit rating agencies will be increased with wholesale withdrawals of funding from institutions on the slightest bad news from the agencies.

Conclusion

The FSOC proposals represent a significant change to a fund industry that has become a major part of the financial system. Any step change to this industry risks triggering unintended consequences elsewhere in the system. The ACT is aware that use of MMFs has become a simple default option for many organisations with surplus day to day cash to invest. We accept that the CNAV set-up does distract from the fact that such funds are not without risk. Improving the awareness of the nature of CNAV and helping investors to understand the implications of amortised cost accounting would help towards making VNAV more acceptable to investors. Publishing the actual daily NAVs would help the messaging. Creating an environment where sponsor support is no longer assumed would help clarify the true risks too.

These are behavioural aspects but worthy of addressing alongside any purely logical topics. We further recommend that the FSOC encourages the accounting authorities to clarify the definition of cash equivalents.

With better understanding by investors, and this is a subject professional treasury bodies and fund manger trade bodies can help with, a move to VNAV may eventually become a more realistic proposition. This, together with the ability to include a cautiously managed VNAV fund as cash equivalent in the accounts would all help to create an environment where your alternative one might, over time, become acceptable.

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The Association of Corporate Treasurers (ACT) is the leading professional body for international treasury providing the widest scope of benchmark qualifications for those working in treasury, risk and corporate finance. Membership is by examination. We define standards, promote best practice and support continuing professional development. We are the professional voice of corporate treasury, representing our members.

Our 4,300 members work widely in companies of all sizes through industry, commerce and professional service firms.

For further information visit www.treasurers.org

Guidelines about our approach to policy and technical matters are available at http://www.treasurers.org/technical/manifesto.

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