Money Market Fund Ratings

Not All AAAs Are Equal

Money market funds (MMFs) are being forced to implement sweeping structural reforms by October 2016. Prime and municipal (tax-exempt) MMFs — favored liquidity management options for businesses, local governments and not-for-profits — face the most significant changes.

A clear lesson from the financial crisis is the importance of maintaining an appropriate level of conservatism when assigning AAA ratings. Investors will rely on these ratings while making critical decisions in the next few months on how to manage their cash post MMF reform. Yet many may not fully appreciate the important changes taking place for MMFs and the critical differences in ratings methodologies among the top three rating agencies.

- Treasurers and cash managers place a premium on principal preservation AND timely liquidity
- Money fund reform will increase liquidity risk due to fees and gates tied to weekly liquidity triggers
- Fitch's money fund ratings address safety of principal and timely liquidity
- S&P's money fund ratings only address principal preservation, not timely liquidity

New regulation require MMFs to place provisions for liquidity fees or gates and switch from a constant to floating net asset value when assessing their positions. The regulation specifically ties fee and gate provisions to the amount of a fund's weekly liquid assets. If these assets fall below 30%, the fund's board may impose a liquidity fee of up to 2%. The board may also suspend redemptions for up to ten business days. If weekly liquidity drops below 10% of total fund assets, fund boards are required to impose a 1% redemption fee, unless the board determines that the fee would not be in the fund's best interest or that a higher (or lower) fee is more appropriate.

Most industry observers believe investors will closely monitor a fund's cushion above the 30% trigger and proactively redeem their investment if a fund gets too close to a redemption trigger. In anticipation of these sweeping changes to MMFs, Fitch updated our rating criteria in December 2015.

A Fitch rating is an opinion on a MMF's ability to meet the dual objectives of preserving invested principal AND timely liquidity. In other words, Fitch's rating opines on the likelihood that investors will get their money back on time and in full, upon request. Reflecting this emphasis on timely liquidity, Fitch's criteria set minimum guidelines that include a meaningful liquidity cushion above mandatory liquidity-based triggers. This means that funds rated 'AAAmmf' by Fitch will need to maintain weekly liquidity in excess of 30% to forestall the potential for a gate or redemption fee.

In February 2016, S&P also updated its rating criteria for MMFs, known as its "Principal Stability Fund Rating (PSFR) Methodology." S&P's updated criteria only speak to a fund's ability to preserve principal, not its timely return of principal. Their criteria does not set any minimum weekly liquidity guidelines and does not address the risk that fees and gates could limit timely access to principal repayment. Under S&P's updated criteria, a fund carrying their highest rating of 'AAAm' could impose a full redemption gate for up to five days while retaining the 'AAAm' rating. Alternatively, if the fund elects to impose a 2% redemption fee, S&P views this as a "credit positive," despite the fact that the fund is likely facing an extreme liquidity stress event causing investors in the fund to take a 2% haircut to get their money back.

Money Market Fund Ratings

Not All AAAs Are Equal

Currently, over $1 trillion of money sits in U.S. institutional prime and municipal money market funds. Most of it is used for cash management by businesses, local government, charities and the like that, under their investment guidelines, invest in AAA-rated MMFs as a safe, liquid place to temporarily park cash. This cash is used to meet payroll, cover other operating costs, and meet capital expenditures. Loss of access for five days or a haircut to its value is simply unacceptable for most cash managers.

Another lesson from the financial crisis is that MMFs can play a critical systemic role, given their importance in providing short-term funding to corporations, financial institutions and government agencies. Consider what happened when Reserve Fund, rated AAAm by S&P, was forced to suspend redemptions in 2008. This contributed to a 'run' on prime money market funds and a breakdown of liquidity in the short-term credit markets.

Rating agencies often have different opinions on the nature of risk. In this case, however, we believe S&P's approach for rating MMFs has weaknesses and does not fully serve the needs of investors.

Fitch is committed to serving investors in the money market fund space through thoughtful, forward-looking criteria and research. Investors need to understand fundamental differences in rating criteria that can impact a $1 trillion market. Nowhere is this more important than in the area of liquidity management, where investors value return of principal more than return on principal.

Fitch Ratings – "International Money Market Fund ratings (assigned to money market funds and other cash management products) are an opinion on a fund's capacity to fulfil its investment objectives of providing ready liquidity and preserving principal." *Global Money Market Fund Rating Criteria, December 10, 2015.*

Standard & Poor's – "A Standard & Poor's principal stability fund rating, also known as a "money market fund rating," is a forward-looking opinion about a fixed-income fund's ability to maintain principal value (i.e. stable net asset value, or "NAV") and to limit exposure to principal losses due to credit risk.....We generally do not lower ratings to 'Dm' when the manager of any fund suspends redemptions for up to five business days or meets redemption requests with payments in-kind in lieu of cash, if this occurs because the fund is faced with an unanticipated level of redemption requests during periods of high market stress, and this suspension is permitted under the fund's prospectus." *Principal Stability Fund Rating Methodology, February 1, 2016.*