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Treasury Management

The 11th Hour

Time is running out to reassess your investment policy

Treasury Manangement

KEY TAKEAWAYS:

• Many corporate treasurers have put off addressing their investment policy because the money market fund reforms were so far off. That is no longer the case.

• A mass exodus from prime to government funds that occurs over a short period of time could lead to a severe liquidity crunch. Corporates who plan to move their investments into government funds should not wait until the last minute.

• Corporate treasurers who want to stay in prime funds or explore other types of investments should begin the process now. Audit and finance committees and boards may have to sign off on any investment policy changes, and that can take a lot of time.

ANDREW DEICHLER

Treasurers have had money market fund (MMF) reform on their minds since the Great Recession. But despite having years to prepare, many treasury departments still do not have a handle on how their investment policies will change come October 2016, when the reforms finally kick in.
In a new CTC Executive Perspective, A Dialogue with Asset Managers: Time is Running Out to Reassess Your Investment Policy, AFP speaks with some of the largest asset managers in the world about what treasury should be doing to prepare for these changes. We’ve heard about the floating net asset value (FNAV) and the fees and gates for years—but in less than year, they’ll be here. You don’t want to still be contemplating what to do in September. The clock is ticking

Many treasury departments are not planning to look at changing their investment policies until mid-summer—or when they need to act upon it. A key reason for this inertia among treasurers is that it has been such a slow crawl to get to this point. “We’re closing in on a decade-long process,” said Tony Wong, head of global liquidity for Invesco. “You had the first wave of reform, then the second wave that was announced in 2014. When they announced the date of October 2016, it seemed so far away. I think clients are looking at it and saying, ‘It’s round four; we’ll look at it, but there are other things going on in the world.’”

However, corporate clients are paying more attention to investment policy as the reforms draw near, especially since the Federal Reserve hiked interest rates in December 2015. “For the last two years, money fund reform was viewed as, ‘That’s out in 2016; we still have a lot of time to act on it,’” said Sara Flour, CTP, managing director, liquidity investments for Deutsche Asset Management. “In the conversations we’ve been having over the last quarter, investors have been saying, ‘It’s round four; we’ll look at it, but there are other things going on in the world.’”

Tom Callahan, head of global cash management for BlackRock, explained that the majority of his corporate clients are focused on MMF reform—they just don’t know what they’re going to do about it. “We did a survey a couple weeks ago of all the holders in our biggest prime fund. We just asked what clients’ intentions are; if they’re going to stay, if they’re going to move to a government fund, etc. We’ve been doing this periodically. What jumped out at us was how big the ‘I’m not sure yet’ camp was. That was striking—but not totally surprising,” he said.

Since the reforms were first announced, there has been talk of a mass exodus from prime to government funds. Brandon T. Swensen, CFA, vice president, co-head, U.S. fixed income for RBC, said that his firm is “well aware of a significant intent” to move to government funds. For corporates that are moving to government, he advises them to do so soon. “Our own opinion is that more than $500 billion will probably be moving,” he said.

“There might be a very attractive yield spread between credit funds and government funds. As the industry talks to our clients and tries to get them to focus on this, that’s something people are becoming more aware of—which happens when all this money rushes into government funds and the potential spread advantage of being in a credit fund.”

But it’s quite possible that a substantial amount of investments will stay in prime funds. “There might be a very attractive yield spread between credit funds and government funds,” said John Donohue, CEO, investment management Americas and head of global liquidity for J.P. Morgan Asset Management. “As the industry talks to our clients and tries to get them to focus on this, that’s something people are becoming more aware of—which happens when all this money rushes into government funds and the potential spread advantage of being in a credit fund.”

Key risks

There are substantial risks to putting off changes to investment policy. October is still a ways away, but treasury departments that are planning to deal with this in mid-summer might want to reconsider.
agency funds,” said Justo Gonzalez, head of global liquidity credit research for Invesco. “Maybe that doesn’t happen, but you don’t want to wait and see what the outcome is. You want to be proactive and make those changes ahead of time.”

Wines doesn’t see a liquidity crunch like this as an overwhelming concern, but does believe it is possible. Assume, for example, that over the course of a two to three month period, half of the investors in a $10 billion institutional fund decide to pull $5 billion out and put it into a government fund. “If this were to happen over a $1.2 trillion dollar money market, then you can see what happens,” he said. “If an institutional fund is forced to sell those assets because they have to liquidate—they don’t have the gatekeeping ability and the fees to place upon an investor to keep them from pulling funds yet—you can see how an exodus that’s dramatic over a short timeframe could cause funds to potentially break the buck.”

Still, government funds can take steps to avoid such a scenario. Back in 2008 when the Reserve Primary Fund broke the buck, within about 10 days, about $600 billion moved from prime to government funds and government funds shut their doors. Government funds would likely react this way again should a liquidity crunch appear imminent.
The general consensus is that about 40 to 60 percent of the money in prime funds will move to government funds, noted William Goldthwait, vice president, portfolio strategist at State Street Global Advisors (SSGA). But even if a move of this capacity happens, he isn’t sure that the money will stay in government funds. What he is hearing from corporate clients is some may want to move into government funds temporarily and let the dust settle.

“They’re going to see what happens to prime funds; see how much the NAV varies, see how much liquidity is held and see what the asset flows look like, and then if the yield looks attractive on a relative basis, they might move some of their cash back to prime strategies,” he said. “We do hear a lot from clients about various yield levels that will entice them back into prime funds.”

Other investment options
Aside from government funds, there are plenty of other investment options for corporates to consider. Some are inherently similar to prime funds, however, they may require changes to investment policy guidelines and approvals from the board parties throughout the organization.

Some asset managers are working on private placement funds, which have the same characteristics of institutional prime funds, J.P. Morgan’s Donohue noted. “But that’s still a different product; it’s not a mutual fund,” he said. “So if you have investment guidelines, you have to make sure those guidelines allow you to invest in such a product. And that’s only for direct investors; it doesn’t work for sweeps and omnibus accounts.”

Donohue believes that once corporate treasurers become more comfortable with the concept of a floating NAV, they may consider products that have no gates and fees that could afford them even more of a yield advantage. “You can take a step out into a separately managed account (SMA), or you can go into what we call managed reserves, ultrashort money duration bond funds. And there you’re going to have a much more attractive yield over government or even prime funds than you historically have had. Those funds are going to give you a better return, taking less risk than they have historically had to do. They’re still very low volatility funds as far as NAV, and you won’t be subject to gates and fees,” he said.

Seth Coulson, CFA, vice president and account manager for PIMCO, has also observed some treasury clients considering the ultrashort bond market as an alternative to prime funds, and many of them won’t need to make changes to their policies to get into it. “Most investment policy statements don’t specify whether they can buy mutual funds outside of the 2a-7 space. So in most cases, they do have the potential to buy something that is in the ultrashort bond space,” he said.

But it really depends on the size of the company and the breadth of the treasury function. Robert Burns, CFA, senior vice president and account manager for PIMCO, noted that some of the more mid-sized organizations are looking at the ultrashort bond market as their only alternative to prime funds. “Going into a separate account is fraught with problems for some corporations who aren’t extremely well-stacked in the treasury area,” he said. “On the other hand, companies with treasurers who have the ability to modify the investment policy statement as needed would benefit moving into a separate account. But one of the things we’ve heard is that there’s just not enough yield available to go through all the gyrations of moving to a separately managed account. So consequently, the ultrashort bond market is the best alternative for a lot of these folks.”

Don’t procrastinate
There are many corporate treasurers that have yet to really dig into this, and time is running out. You can wait until mid-summer or even the fall if you want—but as many asset managers have said, if you do decide to make big changes to your policy, it may be too late. So don’t put this off any longer. October will be here before you know it.