J.P.Morgan

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Fidelity announces major changes to its MMF lineup

Short Duration Strategy

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- **This past Friday, Fidelity announced major changes to its money market fund (MMF) lineup in preparation for forthcoming SEC MMF reforms[1].** This is the first major strategic announcement that we are aware of from a MMF family since the new SEC rules were finalized in July 2014. The rules require institutional prime and municipal MMFs to convert to a floating NAV as well as adopt liquidity fees and gates. However, recent MMF reforms impose only relatively minor changes for government MMFs. Importantly, unlike prime MMFs, institutional shareholders can continue to hold shares in constant NAV government MMFs.

- **There are three major changes that are taking place:**

  1. Fidelity will convert three of its prime MMFs into government MMFs. This includes Fidelity Cash Reserves, the largest prime MMF in the industry (current AuM is approximately $114bn)

  2. Fidelity will amend its government MMFs' investment policies to meet the new SEC definition of a government MMF (i.e., 99.5% of assets in cash or US government securities)

  3. Fidelity will merge several funds that have similar investment strategies in order to strengthen and simplify its suite of money market products

- **The changes are expected to take place over the course of 2015.** While the changes have already received approval from the Board of Trustees, some of the changes with respect to fund mergers and mandated conversions require shareholder approval, which Fidelity expects to occur in May. If the shareholders approve, then the mergers and conversions are expected to be completed by 4Q15.

- **We believe the goal of these moves is to ensure that all existing shareholders will be able to continue to participate in stable NAV funds that are not subject to redemption restrictions (i.e., government MMFs)**. To the extent they prefer not to be exposed to low-yielding government securities, individual shareholders can choose to redeem their shares and reinvest elsewhere, either with Fidelity or possibly other managers.

  - For retail investors, which the new SEC rules define as "natural persons", it is quite possible many of these retail shareholders will redeem and migrate away from government MMFs. The new SEC rules allow them to continue to invest in stable NAV prime MMFs, a product very similar to what they currently hold.

[1] https://www.fidelity.com/mutual-funds/news-analysis/money-market-funds-statement

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Exhibit 1: Fidelity's 3 prime funds being converted to government funds have about $129bn of AuM, of which approximately $100bn is invested in non-government securities

Asset allocations of Fidelity Prime Funds that are being converted into government funds* ($bn)

Asset Type	Fidelity Cash Reserves	Fidelity MMT: Retirement Portfolio	VIP Money Market	Total
Certificate of Deposit	61.7	7.3	1.5	70.6
Financial Company Commercial Paper	8.3	0.7	0.3	9.3
Government Agency Debt	9.2	0.5	0.1	9.8
Government Agency Repurchase Agreement	0.4	0.0	0.1	0.6
Other Commercial Paper	1.6	0.4	0.1	2.1
Other Instrument	0.5	0.1	0.1	0.7
Other Note	1.8	0.2	0.0	2.0
Other Repurchase Agreement	13.8	1.5	0.3	15.7
Treasury Debt	7.3	0.1	0.0	7.4
Treasury Repurchase Agreement	9.0	1.5	-	10.5
Variable Rate Demand Note	0.2	0.0	-	0.2
Total	113.89	12.34	2.69	128.93
Total ex government and agency securities	*87.76*	*10.26*	*2.44*	*100.46*

*As of 12/31/2014
Source: Fidelity, Crane Data

- For institutional investors, they are given a choice of staying in the government MMFs or reallocating into a floating NAV prime MMF or some other form of investment, as the new SEC rules exclude non-natural persons from participating in stable NAV prime MMFs.

- It occurs to us that possible advantages to Fidelity's approach include:
  - Creating a clear path to compliance with SEC reforms that should align its fund offerings with shareholder interests well ahead of the effective date of the new rules (October 2016).
  - Existing fund shareholders can exercise their freewill and choose to participate in a MMF that is appropriate to their status as a retail or institutional entity.

- **Although only 3 funds are covered by this announcement, we estimate these had a combined AuM of $129bn as of year-end 2014.** We estimate about $100bn is invested in non-government securities (Exhibit 1). Anticipation of Fidelity's change will likely increase demand for government securities (T-bills, repo, agencies, Fed RRP) while simultaneously decrease demand for non-government securities. Interestingly, the 3 prime MMFs that Fidelity has selected to convert into government MMFs are predominately retail (Exhibit 2). Excluding those funds, Fidelity has 5 other prime MMFs that they manage, also totaling $129bn as of year-end 2014 of which >80% are institutional.

Exhibit 2: Interestingly, the prime funds being converted are predominantly retail

Breakout of Fidelity prime funds

Fund	Type	Assets as of 12/31/14 ($bn)
Prime MMFs Being Converted to Gov't MMFs		
Fidelity Cash Reserves	Retail	114
Fidelity MMT: Retirement Port	Retail	12
VIP Money Market	Institutional	3
Total		129
Remaining Prime MMFs		
Fidelity Inst MM MMkt	Institutional	65
Fidelity Inst MM Prm	Institutional	40
Fidelity Cash Management Prime	Retail	18
Fidelity Select MM Portfolio	Retail	4
Fidelity Money Market	Retail	2
Total		129

Source: Fidelity, Crane Data

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- **Given the strong relationship between yields on short-term bank debt and Libor, all else equal, we would expect Libor-OIS spreads to be pressured wider over the course of 2015. The Libor curve could also steepen as the prospect of greater shareholder redemptions could lead to larger holdings of very short maturity instruments. The magnitude of these changes will depend on:**

    - The market's perception of Fidelity's proposed changes getting shareholder approval;

    - The likelihood of existing fund shareholders choosing to leave the transitioning funds in favor of other funds in non-government securities;

    - Market expectations of other funds following Fidelity's lead (currently there is about $1.47tn invested in prime MMF in the US).

- We have no view on the first of these. On the second point, **while we suspect many of the affected shareholders will ultimately re-align with prime funds, it is not clear how quickly this might happen. The current low level of money market yields doesn't offer much incentive to shift quickly, but the onset of higher rates later this year or in 2016 might change that.**

- This brings us to the last point about other fund families following Fidelity's lead. There are a wide range of business models across the MMF segment of the asset management industry, and while some may follow Fidelity's lead, others will chart their own route with their own timetables. One potential issue presented by competing implementation timelines is that some yield focused shareholders can quickly shift between fund families in pursuit of the "fund of the moment". The probability of this increases in a rising rate environment, and could prompt the kind of institutionally driven redemption related volatility that the MMF reforms were enacted to protect against.

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