Consolidation of Money Funds Coming

Ignites Article published on October 9, 2008
By Peter Ortiz, Beagan Wilcox

Prolonged market turmoil and fear of panic-driven redemptions or breaking the buck may lead some managers of money market funds to leave the business to larger players.

Fund groups may decide they don't have the scale, resources or access to deep pockets that is necessary to continue successfully managing money funds for a profit that's worthwhile, especially given the risks that have been highlighted in recent months.

"What I do expect is that you'll have some companies in the money fund business, particularly after all the turmoil of the last year, rethink whether it's the business they want to be in," says Robert Lee, managing director of equity research at **Keefe, Bruyette & Woods**.

Costs of running a money fund and the pressures of being in the business will continue to rise, says William Katz, senior VP of equity research at **Buckingham Research Group**. Given that environment, he expects larger money fund managers, such as **Federated**, to acquire money funds from smaller players.

The number of funds that have been forced to turn to the advisor or corporate parent — oftentimes a bank — for help to avoid breaking the buck is another likely factor. About 20 groups have had to bail out their money funds during the last 14 months, according to **Crane Data**. Roughly half of those have bank parents that helped the funds.

The **Reserve** Primary Fund, which broke the buck in September, has also increased the fear of a money fund going under because of a run on the fund. While the fund held **Lehman** debt that plummeted in value after the firm's bankruptcy, the real problem was that the fund could not keep up with the huge number of redemptions.

Some industry sources say consolidation is inevitable. Through most of the history of money funds, the difference in yields between the highest- and lowest-performing funds has always been tight, says John Ford, partner at **Pepper Hamilton**.

"People are starting to realize that there is a surprising amount of risk associated with managing a money market fund as opposed to the margins inherent in that kind of product," Ford says. "In a market like this, true credit research is essential, and the problem is there are more money market funds out there than need be."

The crisis also may spawn the return of a master-feeder type structure, where one huge fund operates as the master for different fund families, Ford says. In effect, under this structure small fund shops would bear fewer risks and deal only with distribution and some administrative duties.

"The portfolio management risk would be at the master level, and the sponsor or advisor to the feeder funds would not have the same kind of enterprise risk as the asset manager would have," Ford says.

Other sources say some shops will stay away from institutional investors flush with cash that were once an attractive prospect. Going after the money has been tempered by the risk of having those same institutional investors ditch the fund with large redemptions and jeopardize its survival.

"I think we will end up with fewer fund companies in the money market fund area," says Barry Barbash, partner at **Willkie Farr & Gallagher**. "Some fund companies will decide the retail business is where they want to be, where there is not as much risk of quick redemptions."

Whatever happens, Barbash, who is a former head of the Securities and Exchange Commission's investment management division, says "too much has happened in the market to go back to the way it was."

Others in the industry believe shops won't want to shed their money market funds. Peter Crane, president and CEO of Crane Data, notes that right now funds are simply trying to survive rather than thinking strategically.

"When these advisors hold these securities to maturity, they'll likely make back most of their money," says Crane, referring to advisors who have brought onto their books the troubled securities of their money funds. Crane adds that the perception of the money fund business as being a low-margin one is incorrect. Fund groups will stay in the business for the money, he says.

Lisa Cohen, president of **Momentum Partners**, says it would be tough for a shop to abandon money market funds because they have become a fundamental part of the product lineup and an expectation of the investor.

"It's used by advisors and shareholders as a parking place," Cohen says. "If you don't have that in your mutual fund family, that's going to be challenging."

Federated has already snapped up one struggling **Putnam** institutional fund. Putnam's $12.3 billion Prime Money Market Fund had holdings of an **AIG** subsidiary and experienced a high number of redemptions in the wake of the insurer's struggles and its subsequent $85 billion loan from the Fed.

Putnam said it would stand behind the fund's net asset value but that, if there were another round of redemptions after the one on Sept. 17, it would become increasingly difficult to have the liquidity to satisfy redemptions, says Charles Porter, executive VP of the Putnam funds.

An agreement between the Putnam fund and the advisor's parent, **Great-West Lifeco**, a subsidiary of insurance giant **Power Corporation of Canada**, became unnecessary when the fund trustees voted that it was in the best interests of all shareholders to liquidate the fund, says Porter. The fund was closed on Sept. 17.

"I don't think Power would have stood behind, or anybody would have stood behind, $10 billion [in redemptions]," says Porter.

In a later deal, Federated moved securities from the Putnam fund into its own $22.1 billion Prime Obligations Fund in a $1 per share for $1 per share transaction that left Putnam shareholders with shares in the Federated fund.

Some fund managers may be concerned that they will lose access to a parent company's or advisor's deep pockets if outflows and other problems continue to batter the funds.

"It doesn't create enough headline revenue, but it creates too much headline risk," says Ben Phillips, partner at **Casey Quirk**, referring to the current thinking of some groups, particularly bank-owned asset managers, on money funds.

Meanwhile, the bailouts continue. **Wachovia**, for example, purchased $494 million in Lehman holdings from three **Evergreen** money market funds at the end of September. It's unclear whether the bank and its asset manager are thinking of shedding its money fund business, especially given the current fight over the bank between **Citi** and **Wells Fargo**.

"In light of Wachovia's continued merger discussions, no decisions or changes have been made relative to the firm's asset management capabilities. Evergreen remains committed to the money market funds, and all day-to-day business and operations of Evergreen's investment teams remain intact," says Laura Fay, spokeswoman for Evergreen.

Whether or not consolidation occurs, fund groups will certainly be more careful in determining money fund holdings, says Crane.

"I keep joking to people that money funds had a near death experience, so it wouldn't be surprising to see them get religion," he says. "They're going to get more conservative, more liquid on their own. They don't need regulatory changes."