Northern Trust | Peter Yi, Director, Short Duration Fixed Income on Shaping the Next Gen of Liquidity Solutions

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After almost 18 months of significant industry preparation and focus, we're close to the implementation compliance date for the final money market rules. As we approach the final phases, the industry has spent an incredible amount of time educating investors and refining products to shape the next generation of liquidity solutions. So, how will these changes affect yields, and what can investors expect going forward?

At a high level, you can expect new structural changes for certain money market funds-- specifically, institutional prime and institutional tax-exempt money market mutual funds. These require transactions using a variable net asset value, which will be using a market-based accounting treatment rather than an amortized cost accounting standard. There will also be a clear distinction recognizing funds that service institutional clients and retail clients. Redemption gates in liquidity fees will become a new standard for all money market funds that are not government funds.

While our expectation is that many investors will reassess their current options, and potentially shift into government strategies, we also believe credit strategies will continue to resonate with certain investors. We anticipate an initial increase in demand for government funds, and a decreased demand for prime funds. We are therefore expecting spreads to widen, making credit instruments more attractive over time. Ultimately, we believe that a new equilibrium will form where credit prime funds will have a much greater yield advantage than a government fund. If the yield divergence between these strategies winds enough, we expect investors to shift back into these prime strategies.

What does this mean for investors? For many, these new rules will not meaningfully change the day-to-day experience that money market investors value today. For those investors that cannot tolerate a variable NAV, or any gating possibility, government funds will continue to be available, and remain exempted from these new structural standards. For other funds, the high credit quality and the substantial amount of liquidity that money market funds are required to hold will greatly minimize the likelihood for disruption and instability.

We like to say, liquidity is valued in every market cycle. So despite these new changes, the benefits of using the money market fund should continue to serve an important purpose, helping investors navigate their liquidity challenges.

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