Bond Case Briefs

Municipal Finance Law Since 1971

Money Market Fund Muni Holdings Falling Fast.

WASHINGTON – Money market mutual funds' holdings of municipal bonds fell by nearly $42 billion dollars between the second quarter of this year and the same period last year, a change that is partially the result of soon-to-become-effective rule changes from the Securities and Exchange Commission.

The recorded drop was part of the municipal data the Federal Reserve Board released on Friday in its quarterly Flow of Funds report.

The total amount of money market fund municipal securities holdings in the second quarter of 2016, $216.2 billion, is roughly 16% less than the $257.9 billion the funds held in the same quarter last year. It is a 30% drop from the $309 billion in munis the funds held at the end of 2013.

The decline occurred in the months before a new SEC money market rule is set to take effect on Oct. 14. The rule requires certain money market funds offered to institutional investors to change their method of calculating their net asset value (NAV), or the value per share, to floating from fixed. The rule is designed to prevent investors from getting out of money market funds on a large scale, which happened to the Reserve Primary Fund during the financial crisis in 2008.

Matt Fabian, a partner with Municipal Market Analytics, said that while the SEC rule played a role, the decline can largely be attributed to the trouble tax-exempt rates have had competing with the rising LIBOR. This has happened in the case of retail money market funds, which are not subject to the SEC rule changes but are also seeing large declines.

"In my mind, a big part of the [LIBOR] increase is going to be temporary because the market doesn't know what is going to happen on Oct. 14 when the new [SEC] rule gets fully unrolled," Fabian said.

He added that cash managers are reallocating away from money market funds until then, but that once Oct. 14 comes, as long as "the world doesn't end," he expects some assets would go back into the funds while a significant portion of the allocations away from the funds will remain permanent.

In all, according to Fabian, money market fund muni holdings have decreased to just over $140 billion as of Sept. 14 from more than $500 billion in 2008.

The flow of funds data also showed the general trend of a decrease in household ownership of munis coupled with an increase in U.S. bank ownership of the securities continued in the second quarter of this year. Household holdings of munis were down 5.2% year over year, falling to $1.64 trillion in 2016 from $1.73 trillion in the same quarter last year. Over that same period, bank holdings increased 10%, rising to $524.1 billion from $474.6 billion the year before.

Household ownership of munis is now down 10.3% from its $1.83 trillion of holdings in 2013 and U.S. bank ownership of munis is up 25% from its $418.9 of muni holdings that same year.

The SEC's Investor Advocate Rick Fleming recently addressed the narrowing of household ownership of munis in a speech he delivered at the Municipal Securities Rulemaking Board's

Securities Regulator Summit on Aug. 25. He said that data as current as December 2015 showed individuals owned approximately 70% of munis either directly or indirectly through mutual funds or other pooled investment vehicles, but added that “if you drill beneath those statistics, some interesting – and some might say troubling – patterns emerge.”

Fleming said that the wealthiest one-half percent of U.S. households now own roughly 42% of all munis. The bottom 90% of households hold less than 5%. Additionally, only 2.4% of households hold any municipal debt, he said.

The Bond Buyer

By Jack Casey

September 16, 2016