



# Money Fund Intelligence

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## Northern Trust Encourages Clients to 'Rethink Cash': Interview with Peter Yi

This month *Money Fund Intelligence* interviews **Peter Yi**, Senior Vice President and Director of Money Markets at **Northern Trust**. Northern is the 11th largest manager of money funds in the U.S., but its footprint in the cash marketplace is even larger given its presence in securities lending, reinvestment and enhanced cash pools. **Our Q&A follows.**

**MFI:** How long has Northern been involved in running money funds?



Peter Yi

**Yi:** Northern Trust has been managing money market funds since the 1970's when Northern created its first cash sweep vehicle in our trust

department. **We have been doing this for a long time and continue to be very committed to the money market business.**

We are now managing about \$225 billion in AUM across various money market and short duration products and strategies. History tells us that experience and leadership are critical for the money market business and has served us well in successfully navigating tumultuous times.

**MFI:** What is your biggest priority currently? What are you working on?

**Yi:** We spend a lot of time thinking of the future, performing deep analysis and forecasting on how the

money market industry will evolve. **Our view is that liquidity is valued in any market cycle, and so we feel very good about our business model and how we are positioned.**

As of late, we have been investing a great deal of time focusing on the regulatory proposals for money market funds. We believe the money market landscape will change and so we are ensuring that Northern Trust is nimble enough to adapt quickly.

Aside from the regulatory debates, one strategic focus has been on our **ultra-short product offerings**. Investors have been drawn to our ultra-short fixed income strategies as some money market investors seek more yield while core fixed income investors position for higher interest rates at some point. **We believe the ultra-short fixed income space will continue to gain traction.**

**MFI:** What's the biggest challenge in managing money funds today?

**Yi:** Supply dynamics in the money market sector will be

**the major challenge in the intermediate to long term, as issuers and investors respond to regulatory change at the same time the financial system deleverages on a large scale.** Money market portfolio managers are very focused on high quality issuers within short maturity instruments.

However, the broader theme of deleveraging in the financial system

will make it much more difficult to source high quality financial instruments that were traditionally available



## Northern Trust

to money market funds. The sensitivity to regulatory metrics such as capital and leverage ratios will continue to strain issuance. In addition, issuers, globally, are being driven to be less reliant on short term wholesale funding and motivated to seek longer term liabilities. Meanwhile, ever since the 2010 SEC money market amendments were adopted, money market funds have been mandated to seek shorter-maturity instruments. **We expect that these conflicting mandates will continue to be challenging.**

**MFI:** What are the funds buying now? What aren't they buying?

**Yi:** We have been focused on constructing a **credit barbell strategy**. In that strategy, we have been purchasing credit in shorter maturities

and taking duration in longer government securities. Even for our prime funds, we are maintaining a strong overweight to government securities. **With short term interest rates anchored at zero for the next few years, short term credit spreads remain very tight, if not the tightest of the year.**

The relative value for government se-

(Continued on page 2)

(Northern's Peter Yi from p.1)

curities has become much more compelling to us. **We have also been seeking high quality foreign agencies and supranationals when those opportunities present themselves.**

Within the credit sectors, we have a preference for the **Canadian** and **Australian** banking sectors. These two sectors have performed very well throughout the recent crises. They continue to be well capitalized and have emerged from the credit crisis as the strongest institutions.

*MFI: What are your customers concerned about these days?*

**Yi: There is no doubt that our investors have questions surrounding the recent SEC proposals introduced back in June.** Specifically, they are concerned with how the new proposals will impact their traditional use of money market funds. They are concerned with situations where they cannot access their cash when they need it. They also have concerns surrounding the accounting and the tax treatment of their money market fund holdings if segments of the industry move to a variable NAV. The regulatory uncertainty at the very least gives them reason to pause and reflect on how they use money funds and are willing to see what other liquidity solutions we can offer.

*MFI: How are fee waivers impacting Northern's money funds? Is Northern committed to the business?*

**Yi: Without question, Northern Trust is committed to the money market business. Money fund waivers have certainly been gaining a lot of attention over the last few years and have made managing money funds more challenging.** But having robust money market offerings, which are guided by our conservative investment philosophy, is something that our clients ap-

preciate and expect as part of our investment suite and service model. Northern is a customer-centric organization so the products that our clients value the most will guide our business strategies.

*MFI: Do you guys manage ultra-short bonds or enhanced cash? How about separately managed accounts or securities lending reinvestment pools?*

**Yi: We offer a full range of short duration products and strategies. We have a very long history managing ultra-short fixed income funds that are synonymous with what the industry refers to as "enhanced cash."** While we have been managing ultra-short strategies since the late 1980's, **we have seen incredible growth in this asset class over the last few years.** We launched our first ultra-short fixed income mutual funds in 2009 and the AUM has grown exponentially since then. **The continued success of Northern Trust's ultra-short strategies validates our view that clients value a strong and proven investment process in a total return product that is different than a traditional money market fund.**

For money market-like strategies, **we also offer offshore Global Cash Funds, separately managed accounts and securities lending reinvestment pools** that are managed consistently with our registered 2a-7 money market funds. What resonates most with our investors for these products is our conservative investment philosophy that emphasizes credit research and risk management.

*MFI: Tell us about your offshore funds and the European environment.*

**Yi: We manage a full suite of Dublin-based offshore Global Cash Funds offered in multiple currencies (USD, GBP & EUR).** Our Global Cash Funds fall under the UCITs directive and follow the strict standards imposed by the **IMMFA Code of Practice.** Northern Trust's offshore Global Cash

Funds would be considered under scope for the European money market regulation proposal by the European Commission (EC). The EC proposals are being viewed as much more punishing than what is currently being proposed by the SEC. **At a very high level, the EC proposals require European money market funds to either establish a 3% NAV capital buffer for a constant NAV or alternatively, operate under a variable NAV.** While the implications for some of the provisions are concerning, **we also believe the EU process is much slower than in the US and we expect a vigorous debate within the individual parliaments.**

*MFI: What is your outlook for the coming year and the future of money funds?*

**Yi: From a portfolio management perspective, we expect the interest rate environment will continue to present a challenging operating environment.** The overall supply constraint themes will continue to play out in an unfavorable way. Our expectation is that monetary policy will continue to be incredibly accommodative. Even if the Federal Reserve begins to taper its large scale asset purchase program in 2014, our view is that the target fed funds rate will remain near zero. **If the universe of high quality issuers continues to**

(Continued on page 3)

(Northern's Peter Yi from p.2)

shrink, we would expect spreads to grind even tighter, putting pressure on the economics of the money fund business. While we think it's manageable for Northern Trust, it will have repercussions within the industry, favoring more consolidation.

In addition, we are hopeful that we will get more clarity around the regulatory proposals for money market funds around the spring of next year. Regardless of what is ultimately adopted, we think the money market sector will continue to exist and serve a valuable purpose within the financial system.

**MFI:** Is there anything you'd like to add?

**Yi:** We think what differentiates Northern Trust is that we take an in-

telligent solutions-based approach to cash management. We focus on a segmentation strategy that defines and allocates cash into different buckets. We challenge our clients to really "rethink cash" in a way that optimizes their expectations for risk, liquidity and return criteria. We offer our clients the opportunity to segment their cash into 3 distinct buckets: operational cash, reserve cash and strategic cash.

Operational cash is used for short-term spending needs. Reserve cash is for intermediate spending needs, and strategic cash is for longer term cash needs. Each segment has different

characteristics with different risk, return and liquidity expectations. Our "rethink cash" approach has really engaged our clients in a meaningful way. It's been a powerful framework to get clients to better align their expectations for liquidity, risk and return. Because at the end of the day, cash can be a very expensive insurance policy, and there could be a more optimal way for our clients to manage their cash if they have flexibility. ♦

**"We think what differentiates Northern Trust is that we take an intelligent solutions-based approach to cash management."**

- Peter Yi

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### Crane Data LLC

112 Turnpike Rd. #303  
Westborough, MA 01581  
**+1-508-439-4419**

<http://www.cranedata.com>