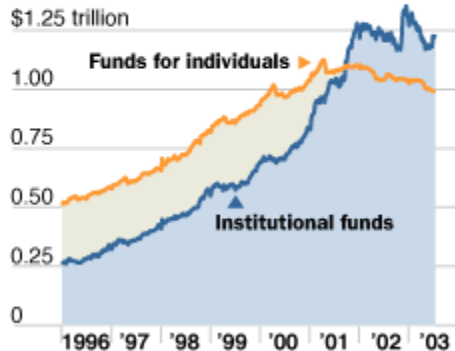




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MONEY FUNDS' BIG FANS

Corporations and other big investors have pumped cash into money-market funds over the past few years and assets of institutional money funds now exceed those of funds for individuals.



Source: Investment Company Institute

Institutions Are Putting More Cash Into Money-Market Mutual Funds

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While tumbling interest rates have prompted some individual investors to pull out cash from money-market mutual funds, that same rate trend has led some corporations, municipalities and other institutional investors to rush in.

Assets in money funds for individual investors have shrunk 12% from a \$1.1

trillion peak for April 2001, as people have shifted dollars to bond funds or banks in search of higher yields. But assets in institutional money funds have risen 28% to \$1.2 trillion during the same period.

A big part of the appeal of money funds to institutions: Every drop in interest rates paid on commercial paper and other money-market instruments isn't matched immediately by a fall in money-fund yields because money-fund portfolios include instruments purchased earlier and still paying interest at higher rates.

As a result of that delayed reaction, "the money-market funds are going to lag the rest of the market" when yields are dropping and temporarily offer investors higher returns, says Jim Hartley, chief investment officer for the state of Ohio, which recently had \$337 million invested in a half-dozen money funds.

Of course, money-fund yields also will lag behind the market whenever interest rates begin moving up again. That raises the question of how much of the institutional cash that has surged into money funds as rates declined will move out when rates start to increase.

The institutional response is expected to vary. Some big investors may well sharply

reduce their use of money funds, in some cases going from having the majority of their operating cash parked in funds to having only, say, 20% there, says Tom Newton, a senior managing director of Institutional Cash Distributors, one of several electronic "portals" that offer one-stop shopping to institutional buyers of money funds. Because some institutional investors aggressively shop around for yields, "we are obviously going to see some money pulled out" of money funds when rates rebound, he says.

But Mr. Newton and others don't expect the assets in institutional money funds overall to drop precipitously -- partly because corporations and municipal governments that hadn't been money-fund users in years past are finding they are handy parking places for cash. Indeed, while money funds have been a solid hit with individual investors since the late 1970s, their widespread acceptance as a cash-management tool for corporations and municipalities has been a far more recent and still-developing phenomenon.

The state of Ohio, which began using money funds only about four years ago, recently had 7% of its operating cash in the portfolios. That usage won't necessarily change whenever rates rise, Mr. Hartley says. "Although yield is certainly a consideration," he says, "our investment officers use money-market funds due to the convenience and liquidity they afford us for a small portion of our daily cash-management duties."

Ohio started using money funds when it was looking at how to invest the payments it would receive under the states' master settlement agreement with the tobacco industry. Big institutions such as state governments typically make direct purchases of commercial paper, short-term government debt or other money-market instruments to earn interest on their excess cash. But the tobacco payments often arrive late in a day, when there may no longer be a good selection of money-market instruments available for direct purchase, Mr. Hartley says.

In contrast, putting that cash -- most recently a payment of about \$200 million received by Ohio on April 15 -- into a money fund "makes for a very easy investment for us," he says.

Similarly, it was only about three years ago that NCCI Holdings Inc., a Boca Raton, Fla., company that compiles workplace-injury statistics for the insurance industry, made a concerted effort to shift cash earning no interest in its bank checking accounts to interest-paying money funds. During the first year, when rates were considerably higher than currently, that effort saved more than \$100,000, NCCI Treasurer Craig Ehrnst says.

NCCI, which keeps \$50 million to \$60 million of operating cash in a money fund, doesn't buy money-market instruments directly and isn't planning to do so even if rates start rising again.

Some corporate stakes in money funds are large indeed. AT&T Corp., which has built up a \$5 billion cash cushion on its balance sheet during the past couple of years, has the majority of that cash spread among about 30 money funds, Assistant Treasurer Jim Hodge says. He expects the telecommunications company to keep most of its cash in money funds even if rates rise. AT&T, like many companies, considers "safety, liquidity, then yield as a third factor," when investing cash, he says.

As recently as the early 1990s, corporate treasurers viewed money funds very negatively, says Anthony Carfang, a co-founder and partner of consultants Treasury Strategies Inc. in Chicago. Using a money fund carried "a sort of a stigma," he says: The thinking among treasurers then was that "money-market mutual funds were for people who didn't know how to do it themselves."

That began to change, however, when an early-1990s drop in interest rates highlighted the benefits of the funds with their lagging portfolio yields, Mr. Carfang says. Over the years, as corporations have trimmed their treasury-department staffs, those leaner operations increasingly have found it convenient to turn over some of the work of investing the businesses' operating cash.

J. Charles Cardona, vice chairman of big money-fund manager Dreyfus Corp., says corporate treasurers accustomed to making direct purchases of money-market instruments "needed to get comfortable with the concept of buying through a pooled vehicle." There was "growing acceptance" by the mid-1990s, he says, and Dreyfus, a unit of Mellon Financial Corp., began calling on potential corporate users for its money funds.

In an era when Enron Corp. and other issuers of commercial paper -- which are a form of corporate IOUs -- have run into financial problems, some institutional investors have come to further appreciate money funds as a way to limit credit risk involved with investing directly.

Years ago, an institutional investor might have been comfortable putting a few million dollars into the commercial paper of one issuer, says James Getz, a division president at Federated Investors Inc., another big money-fund manager. But today, he says, "they are more leery of buying individual money-market instruments than they have ever been before." Mr. Getz says those credit concerns will limit the amount of institutional cash that flows out of money funds if and when rates begin to climb.

The move by corporations and governments to increasingly use money funds hasn't always been hassle-free. After the New Mexico state treasurer's office put \$400 million into an AIM Investments money fund in September 2001, it was taken to task by the state attorney general and state Board of Finance for having made an investment that wasn't authorized under the treasurer's then-current investment policy. That policy since has been changed to add money funds to the list of

approved investments and the department recently had \$160 million of state funds parked in a money fund, investment officer George Everage says.

Looking ahead, Mr. Carfang says one wild card potentially could crimp the appeal of money funds to corporate treasurers: proposed federal legislation that would allow banks to pay interest on commercial checking accounts. If that were to pass, he says, "there could be some really interesting dislocations," including a significant shift of dollars from money funds back to banks.

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