

Dodd Frank and Its' Impact to Money Markets Funds

Barry Weinstein – July 2011

Much has been said about Dodd-Frank. One thing is for sure the 3-6-3* rule that I was taught as the core of commercial banking when I started my career at Chase Manhattan bank is gone. The Fed has decreed no longer the banks can “bet” with the Fed to backstop them if they bet so large they fail. Markets that ran fairly well- until they did not are getting some “attention” under Dodd-Frank. Let’s look at Swaps as an example.

Today swaps participants usually do not have to set aside an initial margin, or capital amount, and they must post collateral only when the mark-to-market value of a transaction reaches a minimum threshold, and swaps market participants can use investment-grade bonds and non-agency mortgage-backed securities, which until now have been accepted as eligible collateral.

For example, the Dodd-Frank rules could require an initial margin ranging from about 0.5 percent of the swap notional amount for a vanilla 2-year interest rate swap, to more than 10 percent of the swap notional amount for a 30-year interest rate swap.

Dodd-Frank leaves no stones unturned - the swaps provisions apply to life insurers as well. Life insurers may have to meet new margin requirements and post only cash, U.S. government securities or other highly liquid securities as collateral.

It will also impact corporations who would now have to post cash collateral so support swaps undertaken to hedge commodity or other costs , repatriate sales/profits overseas, etc.

Needless to say some experts estimate the additional cash collateral required under Dodd-Frank to be close to 1 Trillion dollars. All of that cash collateral would have to be in “risk free” short term deposits. If so, it would be reasonable to assume that the impact to the money markets will assure low short term rates in the intermediate term in absence of any QE3 and as I suggested in 2009 – there will be some changes to the Money Market Funds. I suggested it is a scale business now even more so with these historically low rates. Rationally, there will be some need to “centralize or further commoditize” the management of all “collateral” required for an organizations business activities which will place the prime brokers and global custodian banks in the best position to grow their business.

*3-6-3 rule- take money in at 3%- lend at 6% - be at the golf course at 3.