



Money Fund Intelligence

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Big Leagues of Cash: BNY Mellon's CIS

This month we profile the **Dreyfus money funds** and interview several veteran members of **BNY Mellon's** new **Cash Investment Strategies** unit, one of the world's largest. We speak with **Charles Cardona**, President of **The Dreyfus Corporation** and BNY Mellon Cash Investment Strategies, **Patricia Larkin**, Chief Investment Officer of CIS for the Taxable 2a-7 and Tax-Exempt Money Funds, and **Louis Geser**, Director of Short Duration Credit Research. Our Q&A follows.

Q: What's new with Dreyfus, BNY Mellon and CIS?

Cardona tells us, **"We've been working to integrate all of the BNY Mellon short duration, fixed income activities under a division of The Dreyfus Corporation called BNY Mellon Cash Investment Strategies.... [W]e are managing over \$550 billion dollars in terms of assets within short duration fixed income."** Our goals were three-fold. First, we wanted a unified credit and risk analysis approach supporting all of our separate products under the short duration fixed income space. Second, this has enabled us to consolidate a large portion of our distribution and client coverage efforts across different products. Third, [it's allowed us to] provide all CIS constituents with a consistent process across all of our portfolio activities whether it is money market funds, bank commingled funds, separate accounts, stable value, or securities lending reinvestment proceeds. All of these now comprise CIS."

Q: What's the biggest challenge managing your money funds?

Larkin answers, **"I think it would really be capacity issues.** Twenty five years ago, we had a lot more banks that issued hundreds of millions of dollars in CDs every day. In the commercial paper space over the last two years, there has been tremendous consolidation and less issuance. It's been more and more difficult to find corporate issuance day to day. The asset-backed market has shrunk considerably the last two years."

Geser adds, **"Another dimension of capacity risk is correlation risk.** To the extent that the major issuers in the markets are financial intermediaries, the con-

centration within available 2a-7 capacity has gone from a more robust tier-one corporate credit ecosystem to one primarily consisting of financials. Asset backed commercial paper give us an opportunity to at least replace part of that. [But] now of course that entire asset class, including the multi-seller and single sponsor, has really diminished in size. Other than select corporate issuers where we can find pockets of capacity, the big issues from a credit perspective revolve around the assessment and the stratification of risks within banks."

Q: Have you seen these 7-day put deals?

Geser responds, **"The BBVA deal was a small issue relative to their overall balance sheet, but it's an intriguing product. There are other products out there that in one way shape or form begin to resemble some of the extendable product that was issued pre-crisis. That, I think, we do have some reservations about.... [W]e are watching this with a fair degree of interest and we want to see how the market evolves."**



Charles Cardona

Geser answers, **"We are somewhat more constructive with respect to the 'contagion' hypothesis. We believe that credit and individual issuers can continue to be stratified by specific variables around the contagion theme that allow you to make independent calls on specific issuers. We are comfortable with that up to a point; I would say more broadly that there are real, tangible sovereign risks globally in terms of debt metrics. Inside of the sovereign risk issue and from a credit perspective, we believe that the universal banking model will survive.... But I would argue from a credit perspective that it is important to position these kinds of issuers within compartments because a lot of exogenous risks remain present."**

Cardona adds, **"The only other comment I would like to make on Europe is from a client perspective.... We have had a lot of inquiries and client calls about what was going on, and we did see a couple of customers move to a government or treasury portfolio. But it really was very minimal, and I would say it has largely calmed down over the past several weeks."**

Q: Can we survive at these rate levels?

Cardona responds, **"We can survive. Clearly, we have a lot of scale and enough yield to operate profitably. We are certainly not at the levels that we would like to be, and that is painful to us both as an asset manager and to our distribution partners who obviously have to share in that waiver process.... At one point earlier in the year, we thought that maybe the Fed would begin to raise rates in the fourth quarter.... [But] based on what you read and see today, it looks like this could certainly go into 2011."**

Larkin comments, **"I gather that we are going down the path of low rates for an extended period of time, until ... we start to see some real growth in this domestic economy.... As it is always the case, it will be well-advertised when the Fed is going to move. Then you will start to see rates trickle up before they start to officially raise rates. At this point, it is anybody's guess. But it would certainly seem to me that it's months and months away."**

Q: How has your portfolio changed?

Larkin tells us, **"I think that anyone who manages a money market fund has changed the way they manage their funds since Sept. 16, 2008.** That's just a simple fact. I would dare say we have always been one of the most conservatively managed in the industry — but you can always find a way to be more conservative. The regulatory reform in our opinion is really a maturity issue. The top fund complexes have always had ample liquidity built into their portfolio structures, and transparency is not an issue. The average maturity just makes everything a little bit more plain vanilla than it was, but it certainly is not an issue to manage. When we have a yield curve, we will all be able to produce attractive yields even with a shorter average maturity and greater liquidity due to the size of these funds."

She adds, **"Reform is welcome. I think it makes all the funds march to the same drummer. Post September '08, even without the reform, we would still be managing our funds with greater liquidity because that's what the shareholder base currently requests and needs. From a psychological perspective, this asset class has changed in a**

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sense that it's just more conservative. The people in these funds are savvy investors. They want to know, when they pick up the phone, that the answer is, 'What time would you like your money back?'"

Q: Do you need to be a giant to run money funds these days?

Cardona answers, **"I think you clearly need significant enough scale to support what certainly has been growing fixed costs to support this business.** We have steadily added resources by hiring additional credit analysts, to provide supplemental risk analytics. We've added client-facing resources. I think scale is [also] important, particularly with the level of rates now. It is a scalable business where you can recover your fixed costs as long as you've got enough assets to make it worthwhile. It must be a core competency business, not something you just want to do on the side."

Q: Is Dreyfus more of an institutional or a retail manager?

Cardona tells us, "We are a combination of both, but we are definitely more heavily weighted towards institutional funds. While certain procedures have now been codified into 2a-7 about knowing your customer, that is something that we always had a very robust process around, both through our field

sales coverage ... and our technologies and systems. With the exception of what the entire industry lived through in Sept. '08, that process for us have been very, very successful and nearly flawless."

He says, **"Certainly we have always viewed cash and continue to view cash as a very attractive long term cyclical growth business.** It's always characterized by periods of higher highs and higher lows. We are certainly a very active distributor through all channels, because we want our funds available by whatever means a client would want to purchase them. Whether that's working closely with intermediaries to get our funds approved — that's certainly a robust channel of distribution for us — or portals, which certainly bring an important service to segments of the market, we want our funds to be available there."

Cardona adds, **"I think where we view our biggest growth opportunity is offshore.** We have a family of Dublin-based funds that are up a bit this year, while as you know the 2a-7 funds here in the States are down. We also think we have a significant opportunity for our **separate account business**, so we are placing additional resources offshore to replicate some of the strategies both from an investment perspective and a distribution perspective that we do here in the States. If we can deliver those in alternate currencies and alternate geographies, we view that as, likely, our greatest growth potential."

Q: Any thoughts on the future?

Cardona responds, "A couple of observations, although the crystal ball remains cloudy. We've all been waiting for the recommendations from the **President's Working Group....** The good news is that the regulators are now all actively talking to each other to try and really come to an informed decision.... **As you know from our comments, we are an advocate of retaining the dollar per share pricing.** We supplemented that with a fair bit of research from our proprietary clients saying the dollar price was important to them. **We are hopeful that the dollar price survives, because we think that given its history — outside of the bump in the road of 2008 — it's been successful.** With the additional controls now in place, it can continue to be a viable and efficient service."

Finally, he says, "If it survives, perhaps it does so at a cost. The concept of the private liquidity bank floated by the ICI could be constructive, subject to terms and how it would be structured. But we would be supportive of developing liquidity outlets as a mitigating [factor] to the type of circumstances we all lived through during the crisis. Or, might you have to set aside capital reserves? Then it becomes the question of price and what kind of yield you can deliver, and is it viable? We will see how that goes. **In any event, we will be prepared to stay flexible based on demands by both our clients and the regulators.**" ♦

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