Strategy
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Demystifying Private Liquidity Funds

Reaffirming Advantages of Separately Management Accounts

Executive Summary

Important regulatory changes to institutional prime money market funds are forcing new ideas and new interest in prime fund alternatives. With the SEC Form PF aggregate data, we reconstructed a profile of unregistered private liquidity funds promising investors stable $1.00 NAVs without liquidity gates.

We discuss the drawbacks with private funds as being unfamiliar to the institutional cash community, the mishap with a large fund during the financial crisis, the vulnerable liquidity model, the requirement for investor sophistication, poor transparency, the risk of liquidity lockups and share suspensions, and their uncertain future related to systemic concerns.

In the tradition of our recent publications on separately managed accounts, we advocate for separately managed accounts over private funds, highlighting six relative advantages:

1. *A clearer advisory relationship and stronger account governance*
2. *A simpler legal structure and accounting/tax considerations*
3. *Freedom from shared liquidity risk*
4. *Better transparency*
5. *Tailored risk management*
6. *Higher yield potential*

We recognize the merit of private liquidity funds for certain sophisticated investors in special circumstances, but we caution the general treasury management community against plunging in before fully understanding the product's legal complexity and liquidity risk profile.

Introduction

It has been several months since SEC reforms took effect requiring institutional prime money market funds to float net asset values (NAVs) and impose redemption fees and gates. After a steep drop of 92% in assets through the end of October 2016[1], prime funds saw moderate inflows in both January and February 2017. The majority of institutional liquidity investors, however, seem to remain on guard despite an enticing yield advantage prime funds provide over government funds.

It is understandable that the debate on alternative liquidity options that began when the SEC finalized the new rule in 2014 lives on after its implementation. No clear winner emerges to replicate the safety, liquidity, yield, and ease of use of the "old" prime funds, but not for lack of trying. For some fund families, private liquidity funds hold the promise of being the closest replica.

[1] iMoneyNet Domestic Market Shares as of October 31, 2015 and October 31, 2016.

With limited public information in the early stages of marketing, we attempt to lift the veil on private liquidity funds and assess their suitability as a liquidity product for the corporate and institutional cash investor base at large.

The Allure of the Non-2a-7 "Money Market Fund"

Without a doubt, the greatest appeal of a private liquidity fund to institutional investors is the reversal of fair value pricing in NAV calculations to the old amortized cost method, which restores the stable $1.00 NAV. Funds designed to win back institutional prime shareholders may commit to not impose liquidity fees and gates, another undesirable feature from the recent reform.

To allay investors' concerns on investment risk, many, although not all, of the funds may pledge to be in compliance with the SEC's rule 2a-7 on money market funds regarding credit, diversification, maturity, and liquidity limitations. They may disclose holdings data more frequently than required. A portfolio manager may apply the same investment strategy and run the fund concurrently with registered money market funds. Simply put, the funds aim to replicate money market funds without being labeled as such.

If the funds are as good as money market funds but without the undesirable attributes, what could be their possible drawbacks? The short answer is that they do not provide the same level of investor protection as money market funds or mutual funds in general.

Private Liquidity Funds Explained

The SEC defines private funds as "pooled investment vehicles that are excluded from the definition of investment company under the Investment Company Act of 1940 by section 3(c)(1) or 3(c)(7) of that Act. The term private fund generally includes funds commonly known as hedge funds and private equity funds."[2] Private funds are not registered with the SEC, but their investment advisors may be subject to SEC oversight.

Private liquidity funds entered the SEC vocabulary as the result of the February 2010 money market fund reform, which required private fund investment advisors to file Form PF by December 2012. The SEC defines liquidity funds as "any private fund that seeks to generate income by investing in a portfolio of short term obligations in order to maintain a stable net asset value per unit or minimize principal volatility for investors."[3]

The SEC requires investment advisers with at least $150 million in private funds assets to file, on a non-public basis, Form PF annually for the funds they manage. Advisors with at least $1 billion in combined private and money market fund assets also file quarterly "Section 3" of Form PF. The regulatory agency revised the Form PF to keep an eye on the pooled investments not subject to its oversight, but that may have systemic consequences.

By definition, private fund information is unavailable to non-shareholders. The SEC, however, provides aggregate quarterly fund statistics. Its website has seven quarters of data through the second quarter of 2016.[4] Although the current statistics do not cover the period since the October 2016 reform, investors may still glean some helpful insight into the private fund world.

Liquidity Funds Characteristics

General Statistics: $593 billion of gross private liquidity fund assets were filed with the SEC at June 30, 2016, including $306 billion in parallel managed accounts. They were held in 66 funds managed by 37 investment advisors. The Section 3, or "large" (>$1 billion in combined fund assets), fund category had $564 billion of funds and parallel managed assets managed by 19 advisors.

[2] See the SEC's Private Fund Advisor Resources web page, https://www.sec.gov/divisions/investment/guidance/private-fund-adviser-resources.htm
[3] See the SEC's instruction on Form PF filing, https://www.sec.gov/about/forms/formpf.pdf, Page 5.
[4] SEC Division of Investment Management, Private Funds Statistics, https://www.sec.gov/divisions/investment/private-funds-statistics.shtml

Shareholder Distribution: Section 3 liquidity funds had rather concentrated shareholder distribution, as 30.8% of beneficial ownership belongs to other private funds, followed by "Other" at 14.7%, Non-US individuals and SEC-registered investment companies held 6.8% and 6.6% interests, respectively. It appears that fund investors are heavily skewed towards foreign entities and other pooled investments such as hedge funds and real estate funds. Other than 3.3% from insurance companies, there was no mention of US corporations, educational and municipal entities as shareholders.

Rule 2a-7 Compliance: Though not required, Section 3 liquidity funds may voluntarily claim compliance with rule 2a-7 to appeal to money market fund investors. There are generally four categories of compliance: credit quality, diversification, maturity, liquidity. A fund may claim compliance with none, some, or all of the categories.

As the SEC Form PF table below (Exhibit 1) indicates, a majority of the funds claim some level of compliance, with about half (48.6%) claiming full compliance. Interestingly, the percentage of assets table (Exhibit 2) tells a different story, with less than 20% of the assets claiming compliance. We think this discrepancy indicates the skewing effect of certain large funds not claiming compliance.

Exhibit 1: Rule 2a-7 Compliance (Percent of Funds)

Compliance Type	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2
Credit Quality	65.9	60.0	61.9	61.9	60.0	63.4	61.1	64.9
Diversification	63.6	57.8	59.5	59.5	57.5	61.0	58.3	62.2
Maturity	63.6	57.8	59.5	59.5	57.5	61.0	58.3	62.2
Liquidity	63.6	57.8	59.5	59.5	57.5	61.0	52.8	54.1
Fully	56.8	51.1	54.8	54.8	52.5	56.1	47.2	48.6
None	31.8	37.8	35.7	35.7	37.5	34.1	36.1	32.4

Source: SEC 2Q16 private fund statistics, table 36, from Form PF, Questions 9 and 54.

Exhibit 2: Rule 2a-7 Compliance (Percent of Assets)

Compliance Type	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2
Credit Quality	24.9	24.7	23.8	23.6	21.8	22.4	16.2	17.9
Diversification	24.9	24.7	23.8	23.6	21.8	22.4	16.2	17.9
Maturity	24.5	24.3	23.4	23.5	21.5	22.3	16.0	17.6
Liquidity	24.5	24.3	23.4	23.5	21.5	22.3	10.8	11.2
Fully	23.8	23.8	22.9	22.7	20.8	21.5	10.0	10.4
None	74.9	75.2	76.1	76.2	78.1	77.4	83.6	82.0

Source: SEC 2Q16 private fund statistics, table 36, from Form PF, Questions 9 and 54.

A staff report from the SEC published in January 2017 provides a comparative study of private funds against money market funds through December 2015.[5] The researcher indicated that while most liquidity funds did not formally commit themselves to rule 2a-7 limits, the "vast majority of them held portfolios that were consistent with these limits."

[5] Daniel Hiltgen, Division of Economic and Risk Analysis, the SEC, Private Liquidity Funds: Characteristics and Risk Indicators, January 27, 2017. https://www.sec.gov/dera/staff-papers/white-papers/27jan17_hiltgen_private-liquidity-funds.html

Liquidity: Section 3 liquidity funds appeared to have conservative liquidity profiles, as 77.4% of the aggregate assets were liquid within a day, 96% within seven days and 99.7% within 30 days.

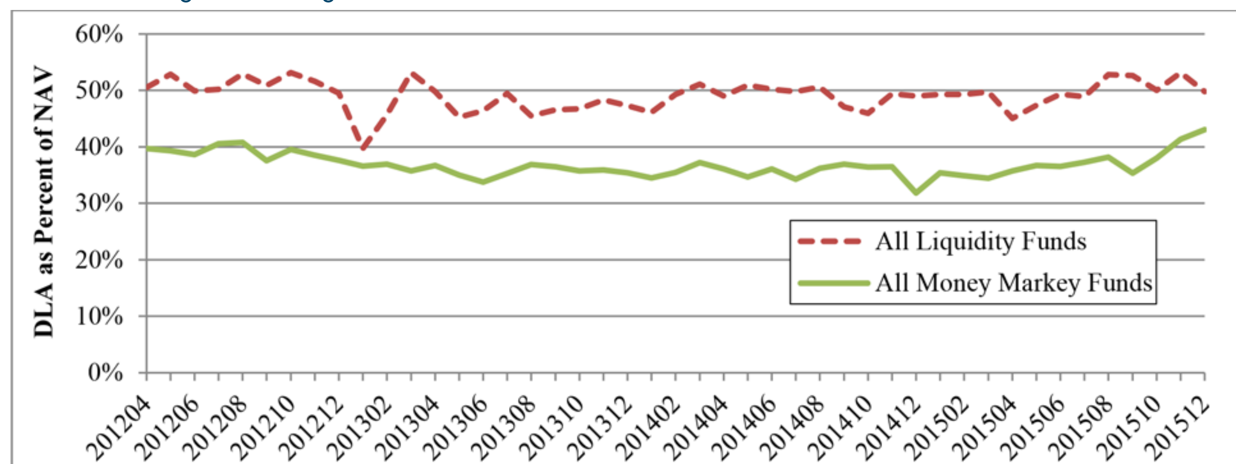
Exhibit 3: Section 3 Funds Liquidity Distribution

Liquidation Period	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2
At most 1 day	70.8	71.9	73.2	73.8	74.1	74.4	81.2	77.4
At most 7 days	91.4	91.4	92.0	92.1	92.3	92.2	96.0	96.0
At most 30 days	99.3	99.3	99.4	99.4	99.4	99.4	99.7	99.7
At most 90 days	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
At most 180 days	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
At most 365 days	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: SEC 2Q16 private fund statistics, table 34, from Form PF, Questions 9 and 64.

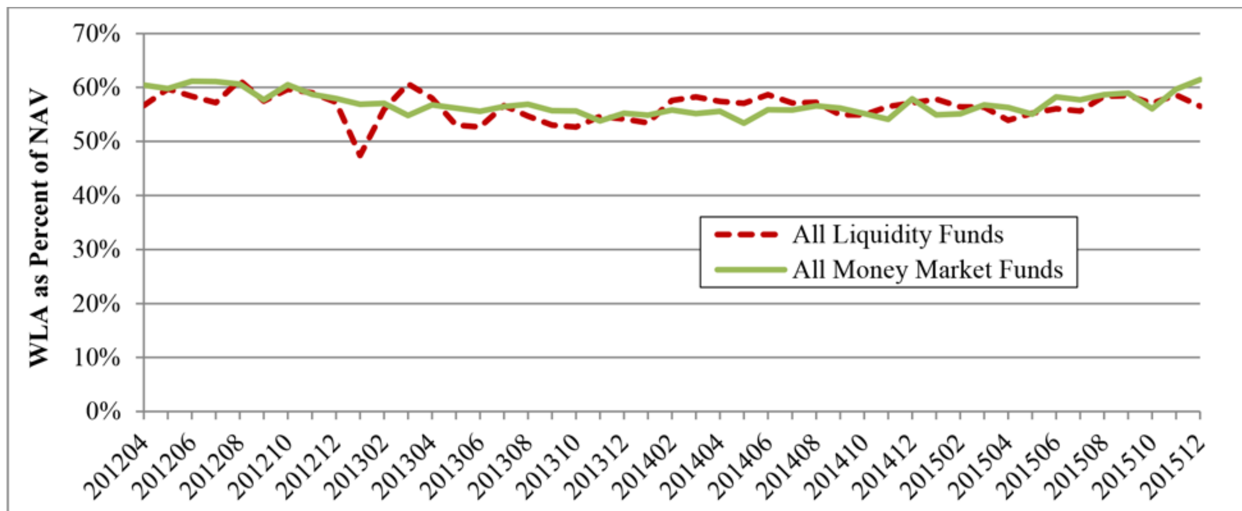
The SEC staff report provides the following graphs that suggest private funds tend to have higher daily liquid asset (DLA) balances than money market funds and about the same level of weekly liquid assets (WLA). The researcher attributed the higher DLAs to several private funds with predominant investments in Treasury securities and government repos.

Exhibit 4: Weighted Average DLAs as a Percent of Net Assets



Source: Daniel Hiltgen, Figure 3 from Form PF questions 55a and Form N-MFP for MMFs

Exhibit 5: Weighted Average WLAs as a Percentage of Net Assets



Source: Daniel Hiltgen, Figure 4 from Form PF questions 55a and Form N-MFP for MMFs

Suspended Redemptions and Gates: Most private funds may suspend redemptions and/or impose gates ("lock-up period" in SEC terminology). As of June 2016, $241 billion of the $258 billion, or 93% of Section 3 fund assets, may suspend redemptions. $207 billion, or 80%, have redemption gates. These funds may be discouraging to institutional prime fund shareholders looking to flee from fees and gates.

Exhibit 6: Suspensions and Redemption Gates

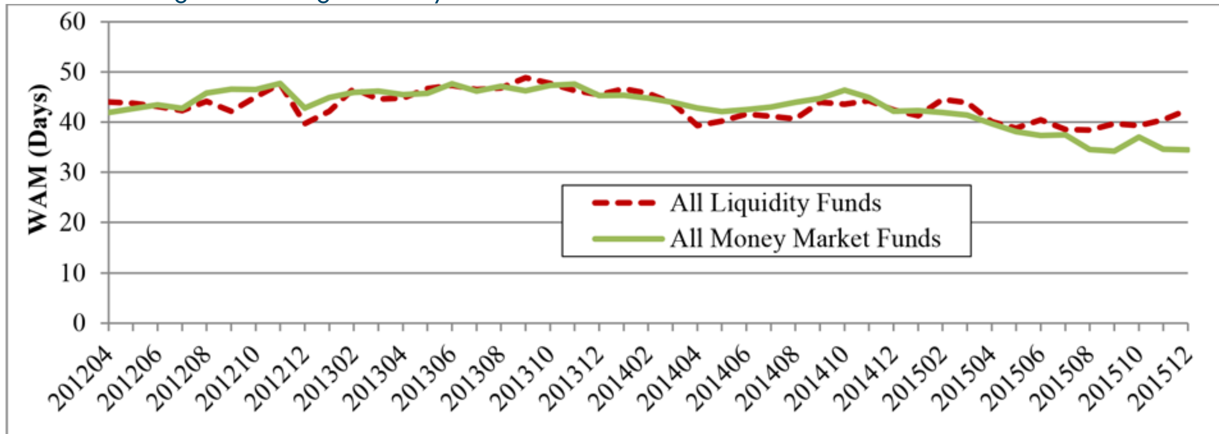
Type	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2
May Suspend	265	255	268	248	252	268	232	241
May Have Gates	234	223	233	215	222	235	200	207
Suspended	0	0	0	0	0	0	0	0
Gated	0	0	0	0	0	0	0	0

Source: SEC 2Q16 private fund statistics, table 35, from Form PF, Question 63.

WAM and WAL: The staff paper provides the aggregate weighted average maturity (WAM) and weighted average life (WAL) characteristics of private funds alongside money market funds through December 2015. The SEC fund statistics report does not disclose such data.

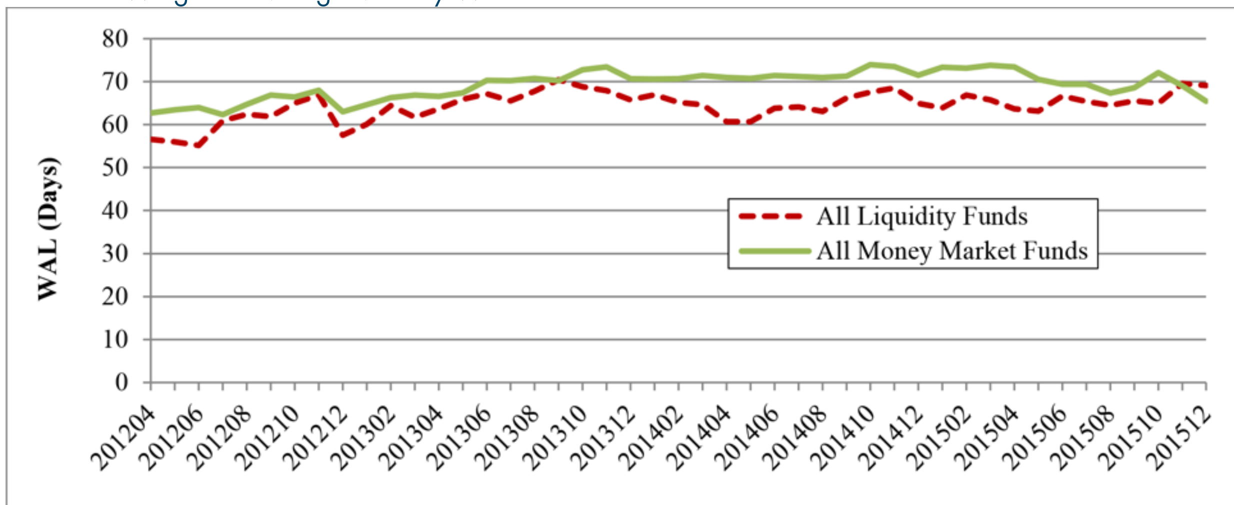
The following graphs show private funds' WAMs (40-50 days) and WALs (55-70 days) were generally in line with those of 2a-7 money funds.

Exhibit 7: Weighted Average Monthly WAM



Source: Daniel Hiltgen, Figure 1, Form PF questions 55d and Form N-MFP Item 11 for MMFs

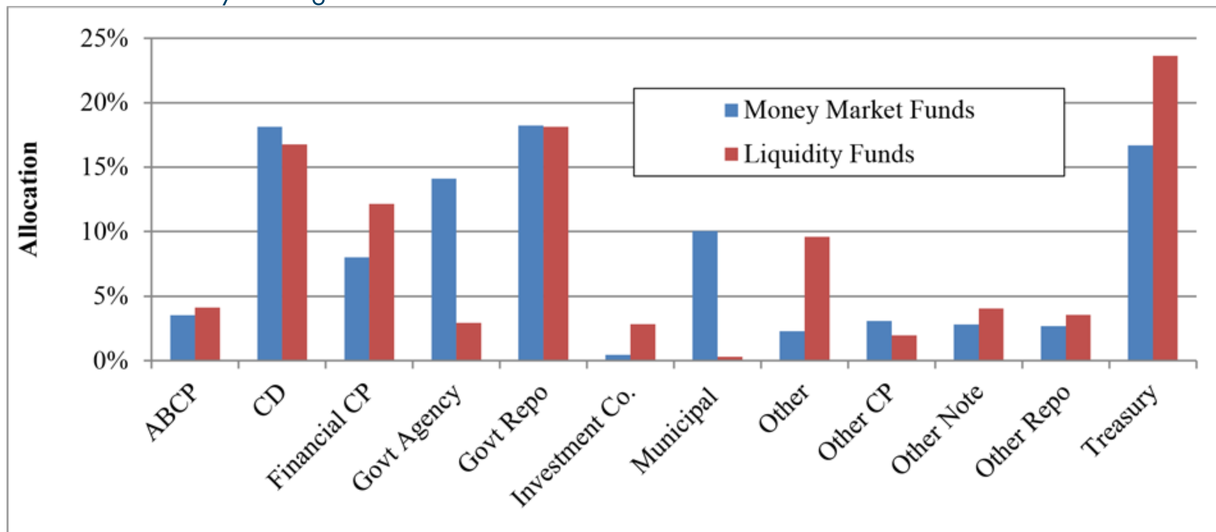
Exhibit 8: Weighted Average Monthly WAL



Source: Daniel Hiltgen, Figure 2, Form PF questions 55e and Form N-MFP Item 12 for MMFs

Asset Allocation: The staff paper found that asset composition in private funds are broadly in line with money market funds, with four highest concentrations in US Treasuries (23.7%), government repurchase agreements (18.1%), CDs (16.8%) and financial CP (12.1%). The researcher noted a lower concentration in agency and municipal securities in private funds than in money market funds.

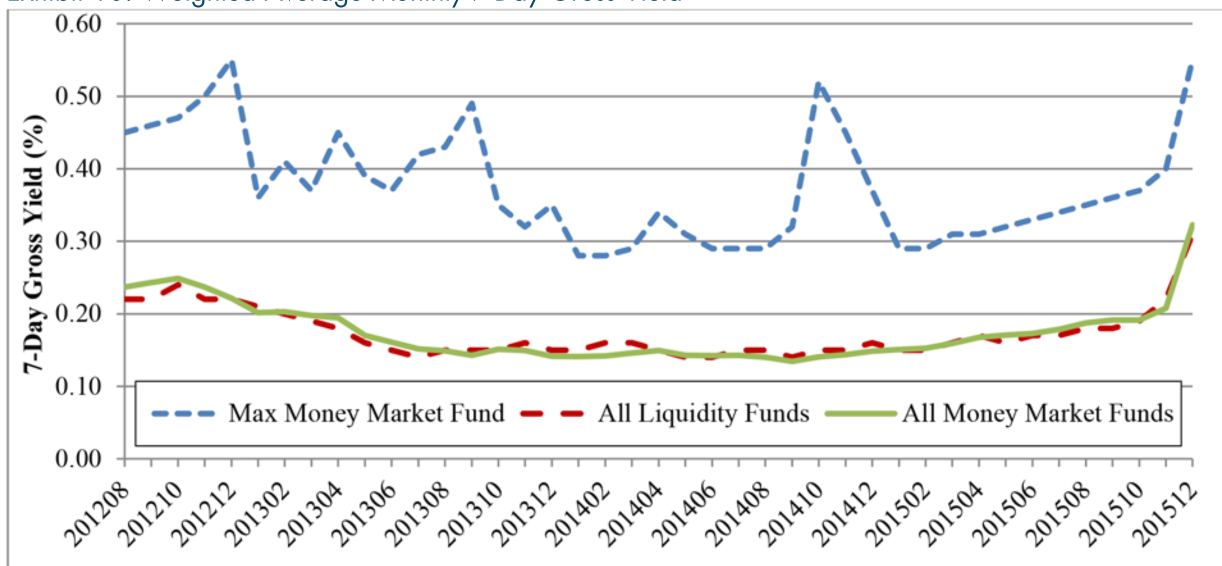
Exhibit 9: Quarterly Average Asset Allocation



Source: Daniel Hiltgen, Figure 12, Form PF questions 56 and Form N-MFP Item 31 for MMFs

Yield History: One would expect the yield history on private funds to resemble that of money market funds, as the liquidity, maturity, credit, and diversification characteristics for the two fund types were broadly similar. The staff paper confirmed this, although the broad yield comparison did not take into account the government, prime and tax-exempt distinctions in either group, which may vary widely for credit and tax reasons.

Exhibit 10: Weighted Average Monthly 7-Day Gross Yield



Source: Daniel Hiltgen, Figure 13, Form PF questions 55(f) and Form N-MFP Item 17 for MMFs

Potential Benefits to Institutional Cash Investors

With the cursory knowledge described above, one may deduce that private funds resemble money market funds but with less SEC oversight, more management flexibility, and perhaps a specialized shareholder makeup using the funds for special purposes. It is possible that, in the wake of the 2016 reform, fund sponsors may have introduced new funds, or substantially changed existing ones, to appeal to prime fund investors. Government money market funds continue to enjoy stable NAVs without the concerns for fees and gates; thus, new interest in

private government liquidity funds may be substantially lower. At the risk of generalizing an asset class hidden from public view, we think private funds may be beneficial to institutional cash investors in the following respects.

Stable Net Asset Values: A private fund's ability to be free of the SEC's fair value pricing requirement, and instead valuing portfolio holdings at their amortized costs (assuming no defaults or impairments) results in the fund having a $1.00 NAV. The ability to round off the NAV to the nearest penny, as opposed to the nearest 100th of a penny is also a significant advantage over money market funds in the event that an impaired security must be priced at fair value below cost. Investors who prefer a stable NAV for transactional convenience or out of risk aversion may be drawn to private funds.

No Redemption Gates: This statement may be inaccurate as of June 2016, because the staff paper found 93% of the Section 3 funds could suspend redemptions and 80% had lock-up (gating) provisions. However, one will not be surprised if funds pursuing institutional prime investors have since revoked the gating provision or introduced new ones without gates. Without public information, investors should do their own homework to examine the lock-up language in related documents. In addition, we think most, if not all, funds will keep the option to suspend redemptions under extraordinary circumstances. As an aside, redemption fees seem to be a subject absent from private fund literature.

Self-Reported Compliance with 2a-7: It is also possible that private funds targeting money market fund investors will claim partial compliance with Rule 2a-7, though they are not required to do so as unregistered funds. A fund also may choose not to claim compliance, but pledge to be managed in a way consistent with the rule. Compliance with 2a-7 is an important distinction as the rule spells out clear limitations in credit quality, diversification, liquidity and maturity parameters to reduce risk. Of course, the onus is on the investor to examine any relevant compliance claims and ensure execution of such claims because the SEC, the normal enforcer for Rule 2a-7, is out of the picture.

Manager Flexibility and Higher Yield Potential: Some private liquidity funds may appeal to certain investors interested in higher yield potential than in a regulated prime fund. A fund may choose to proactively increase risk to add yield by increasing WAM/WAL, reducing daily/weekly liquidity, increasing credit concentration or lowering credit quality. Such funds likely will not claim Rule 2a-7 compliance, although such information may not be widely advertised. Investors should beware of funds whose objectives are inconsistent with their own, and establish risk assessment capabilities to monitor the performance of the funds they signed up with as SEC enforcement is unavailable.

Risk Concerns

A New Concept that Lacks a Following: Despite an established history in other segments of the investor base, private liquidity funds designed to circumvent certain Rule 2a-7 limitations are a relatively new phenomenon for corporate cash investors. Shareholder distribution as reported in the SEC statistics revealed virtually no participation by non-financial corporations, educational or municipal entities. Size may be another impediment, as we are not aware of any funds targeting corporate and municipal shareholders with assets greater than $1 billion, an important milestone to gain institutional following. Insufficient public data and an insufficient track record also add to the impediment.

Guilt by Association: Memory of the $34 billion Columbia Strategic Cash Portfolio, the poster child for a private liquidity fund gone bad, is still fresh in the minds of many a decade after the fund's demise.[6] While some are quick to set apart today's private funds from their "ancient" brethren, the funds' legal structures, regulatory framework (other than Form PF) and shareholder concerns have not changed much.

[6] Tom Lauricella, et al., A $34 billion cash fund to close up, The Wall Street Journal, Page C1, December 11, 2007, https://www.wsj.com/articles/SB119730710066819543

Complex Legal Structure: Private funds are not for everyone, legally at least. The SEC limits shareholders in private funds exempt under Section 3(c)1 of the Investment Company Act to 100 "accredited investors" and "qualified clients." If a fund is under the Section 3(c)(7) exemption of the Act, it may have a shareholder limit between 500 and 2,000 of "qualified purchasers." The funds are organized similar to limited partnerships where each shareholder agrees to the operational, legal and tax requirements for limited partnerships. There are strict legal definitions for "accredited investors", "qualified clients" and "qualified purchasers." The funds typically have no governance bodies and may incur costs in addition to fund expenses. Such complexities often result in offering documents for supposedly simple liquidity products that are several hundred pages long.[7]

Investor Sophistication: One should not lose sight of the fact that private funds are permitted to operate without SEC registration because they are for "sophisticated investors," meaning shareholders knowledgeable of and skilled at understanding risks associated with such investments and well equipped to look after their own interests. In the case of registered money market funds, investors find comfort in delegating their cash investment duties to professionally managed funds regulated by the SEC as they lack such expertise, staffing or other resources. Stepping away from the safeguard of Rule 2a-7 protection means they must rely on the fund manager's promises of professionalism, integrity, governance, capabilities, skills, and adherence to all pledges with limited regulatory and legal recourse.

A Vulnerable Liquidity Model: Our main reservation towards private funds is our understanding of the "public liquidity in a private fund" model, which may be incompatible with some investors. We can envision the merit of a "closed system" where a fund acts as the central liquidity vehicle for a group of affiliated funds, asset collateral or escrow accounts, segregated insurance and real estate funds where the fund manager may anticipate, manage, influence or control expected liquidity. Without significant liquidity restrictions (e.g. imposing no gates) or backup liquidity (e.g. a standby liquidity loan from a bank), we think it is a structural flaw to allow public participation from qualified purchasers of volatile credit and liquidity risk behaviors into a fund with little or no shareholder board representation or regulatory enforcement. Making such investments eligible for daily liquidity on electronic trading platforms may exacerbate a liquidity crunch, in our opinion.

A Step Back in Transparency: The lack of portfolio transparency may lead shareholders to redeem shares indiscriminately first and ask questions later in times of uncertainty, as they did in 2008. The amended Rule 2a-7 requires monthly money market fund holdings disclosures through web posting and the SEC's N-MFP form filing. Many funds disclose weekly or daily holdings to shareholders. Private funds, however, do not disclose holdings publically, and it is up to the fund sponsor to decide on the disclosure frequency to the shareholders. The funds file quarterly Form PF with the SEC, but such information is unavailable to the public. The reduced SEC oversight could lead to shareholder skepticism and distrust of the quality of portfolio disclosure. The lack of transparency may heighten liquidity concerns during market turmoil.

Risk of Suspended Redemptions and Gates: It may be unfortunate for investors fleeing redemption gates in prime funds only to be met by lockups (gates) or suspended redemptions in private funds. Some funds may disavow lockups, but almost all keep their right to suspend share redemptions as a last resort against a run. Faced with the two choices, we think investors may be better off with the 2a-7 gate where, if a fund board chooses to impose one, the SEC allows the gate to be in place no longer than 10 business days in a 90-day period. Lockup periods in a private fund may be substantially longer. Also, a fund claiming not to impose lockups loses a valuable tool to preserve principal. Share suspension, on the other hand, often starts the irrevocable process of liquidating a fund with no clear timetable to access liquidity, as it did with the Columbia Strategic Cash Fund.

[7] Please consult an investment attorney or refer to Section 3 of the Investment Company Act of 1940, amended through P.L. 112-90, approved January 3, 2012, https://www.sec.gov/about/laws/ica40.pdf

An Uncertain Future in the Shadows of Systemic Concerns: The SEC and other financial regulators are mindful of the potential systemic risk posed by large migrations of liquid assets from regulated money market funds and bank deposits to unregulated private pools.[8] The amended Form PF requirement was the regulators' first step to monitor development in this segment of the liquidity market. The SEC appears to be comfortable with the funds' small aggregate size relative to money market funds. Should the funds gain popularity with total assets approaching or eclipsing regulated 2a-7 assets, one may expect the regulators to act forcefully, which may include imposing fair value pricing, redemption fees and gates and or other 2a-7 like limitations.

Six Advantages of Separately Managed Accounts over Private Funds

As an advisor of separately managed accounts (SMAs) for corporate and institutional investors for more than two decades, we are deeply rooted in the conviction that cash investors can and should take control of the risk and reward decisions for their investments. Our inroads into counterparty risk research and analytics led to new insights that commingled fund managers' risk decisions may not always be fully aligned with shareholder interests. We think SMAs deserve a closer look as a compelling alternative to prime money market funds and private funds. Here we briefly offer a specific comparison of SMAs versus private funds for liquidity investors. Readers may visit the research section of our website for other literature related to SMAs.

1. Clearer Advisory Relationship and Stronger Account Governance: In most cases, managers of SMAs are SEC-registered advisors who pledge to act in the best interest of the client. The account is governed by an investment advisory agreement pursuant to the Investment Advisors Act of 1940. Management of client assets is governed by a stated investment policy executed by the client. By contrast, the advisor to a comingled fund works for the fund, which often is controlled or influenced by an entity or persons affiliated with the advisor. Individual shareholders may have little or no direct legal recourse against the advisor. Private fund shareholders hold less sway over fund operations than open end mutual funds which are frequently criticized for their lack of independence from fund sponsors.

2. Simpler Legal Structure and Accounting/Tax Considerations: To establish an SMA account, an investor executes a custodial agreement with a trust bank to open a custody account and an investment advisory agreement to hire the manager. The roles of the parties involved and their responsibilities are rather straightforward. Accounting systems allow flow-through investment report generation for income accrual and gain/loss recognition. The opaque legal arrangements in 3(c)1 and 3(c)7 funds and the cloak of secrecy surrounding how they are run appear more cumbersome and intimidating for the broader treasury management community. Strict rules related to distribution and advertising shield the funds from scrupulous independent researchers and the financial press. The limited partnership or business trust-like structure also involves more complex accounting and/or tax filing requirements.

3. Free from Shared Liquidity Risk: Private funds are by design open only to accredited investors or qualified purchasers, resulting in a high concentration of institutional investors more likely to run than other types of investors. The limited investor base of the limited partnership structure also exposes the funds to large shareholder risk, where the liquidation of one or a few large shareholders could put a fund in a liquidity crunch in the style of the Columbia Strategic Cash Fund or the Reserve Primary Fund. An SMA, on the other hand, has a single shareholder with full access to all available liquidity. An SMA is also more resilient against market contagion risk, in which funds experience runs because another fund with similar characteristics is rumored to be in trouble.

4. Better Transparency: An SMA typically has a custody bank account in the investor's name to hold investments segregated from the advisor's assets. The investor has full access to account information that

[8] Refer to the 2014 SEC final rule document "Money Market Reform; Amendments to Form PF", pages 466-486, https://www.sec.gov/rules/final/2014/33-9616.pdf

may include real-time portfolio holdings and recent transactions. The custodian bank may value the securities independently from the advisor, reducing the chance of deliberate asset mispricing. Private funds have no regulatory requirement to provide shareholders with independently verified daily holdings data or transaction history. The lack of timely disclosure also may expose the funds to "window dressing", a practice of buying riskier securities that mature or will be sold just prior to statement dates to hide them from shareholder view.

5. Tailored risk management: Perhaps the greatest advantage of an SMA is its ability to customize - for the investor, not the manager. A main reason for customization is to minimize risk, as every investor faces unique circumstances that impact income, growth, safety, and liquidity considerations. A commingled vehicle such as a private fund rarely satisfies the preferences of all investors. Sometimes the interests of small shareholders conflict with the larger ones. Otherwise, the interest of the manager conflicts with the shareholders. Investors have little direct influence on the manager's risk decisions other than voting with their feet. An SMA investor may set guidelines and risk parameters around key control metrics such as maturity, concentration, ratings and liquidity not shared by other investors. Should circumstances change, the investor may direct the manager to modify such restrictions.

6. Higher Yield Potential: Though yield is hardly the first priority for most liquidity accounts, yield objective is nonetheless very important – especially for accounts with substantial balances. As most investors would understand, yield in most cases is the byproduct of the risk parameters assumed. In appealing to prime shareholders, some private funds pledge to comply with Rule 2a-7. At the end of the day, the yield potential of a liquidity product with 30% weekly liquidity and 60-day maximum WAM will more or less resemble the yield from a typical 2a-7 prime fund unless one reaches down in credit for yield. An SMA, on the other hand, could realize higher yield potential by moderately expanding WAM (to, say, 120-150 days) and reducing weekly liquidity (since there is no shared liquidity to worry about). A steeper, positively sloping yield curve provides the additional yield boost.

Conclusion

Important regulatory changes to institutional prime money market funds are forcing new ideas and new interest in prime fund alternatives. One such alternative is private liquidity funds, for which the SEC has disclosed some aggregate level information from the Form PF filing.

The private liquidity funds relevant to institutional cash investors are unregistered private assets pools, legally available only to sophisticated investors, that seek to maintain $1.00 stable NAV but without liquidity gates, that may pledge some level of compliance with Rule 2a-7. Other than the NAV and gates characteristics and the exemption from SEC registration, the private funds have the look and feel of regular money market funds.

We discussed several potential drawbacks with private funds as being unfamiliar to the institutional cash community, the mishap with a large fund during the financial crisis, the vulnerable liquidity model, the requirement for investor sophistication, poor transparency, the risk of liquidity lockups and share suspensions, and their uncertainty related to systemic concerns.

We recognize the merit of private liquidity funds for certain sophisticated investors in special circumstances. While much remains to be learned of this revamped product, we caution the general treasury management community against plunging in before fully understanding the legal complexity and liquidity risk profile.

There is no question that an advisory relationship should be a long-term partnership that requires considerable trust and scrutiny. Establishing a separate account relationship may involve some upfront work, but investments in time and research may bring just rewards during times of uncertainty.

About Us

Capital Advisors Group, Inc. is an independent SEC-registered investment advisor specializing in institutional cash investments, risk management, and debt finance consulting. Our clients range from venture capital-funded startups and emerging growth companies to Fortune 100 companies.

Drawing upon more than a quarter of a century of experience through varied interest rate cycles, the firm has built its reputation upon deep, research-driven investment strategies and solutions for its clientele.

Capital Advisors Group manages customized separately managed accounts (SMAs) that seek to protect principal and maximize risk-adjusted returns within the context of each client's investment guidelines and specific liquidity needs. Capital Advisors Group also provides FundIQ® money market fund research; CounterpartyIQ® aggregation and credit analysis of counterparty exposures; risk assessment on short-term fixed income securities and portfolios; and independent debt finance consulting services.

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