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Money Market Reform: Understanding the SEC rules

What prompted these regulation changes?

Lehman Brothers' declared bankruptcy and the subsequent failure of the Reserve Primary fund contributed to a large number of redemptions from institutional money market funds in 2008. The US Treasury and Federal Reserve were forced to intervene in the money market fund marketplace and provide guarantee programs to protect shareholders.

Since the 2008 downturn, the SEC has been implementing reforms with the goal of increasing transparency for investors to prevent runs on money market accounts. These new reforms are the second stage of reforms that were put into effect in 2010 that require money market funds to disclose their holdings to the SEC and allow money market funds lacking liquidity to suspend investor redemptions. (Visit [here](#) for information on the first reforms.)

The changes, phased in over time, include: the use of "floating" net asset value, liquidity fees, redemption gates, increased disclosure requirements, and tax changes.

What are the new regulations?

- | FNAV - Institutional money market funds are required to "float" their net asset value per share (FNAV) to reflect the current market price of underlying securities. Previously, institutional funds priced their funds to maintain a constant net asset value (CNAV) of \$1.00 per share, which potentially understated the portfolio risks. Pricing using a floating net asset value (FNAV) allows investors to better assess the risks associated with interest rate sensitivity.
- | Liquidity fees and redemption gates - Fund Boards of Directors may enact liquidity fees up to 2% and redemption "gates," which limit investor liquidations in times of financial "stress."
- | Increased disclosure requirements – Fund sponsors are required to post liquid asset levels, market-based net asset value (NAV), and instances of sponsor support, liquidity fees, and redemption gates on the fund's website.
- | Tax changes – The U.S. Treasury simplified reporting requirements associated with using FNAV and revised "wash sale" rules regarding money market fund transactions.

How do these regulations affect fund sponsors (company offering fund)?

Institutions face increased operational costs as they review their previous policies regarding assigning "fair value," due diligence processes, and reporting standards. Due to a fund's ability to alert managers and investors alike when approaching a liquidity threshold, managers must closely monitor and adjust investment strategy as needed.

Fund Boards of Directors accept the responsibility to manage liquidity in terms of implementing liquidity fees and redemption gates.



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Do these regulations affect investors?

With the greater transparency of risk associated with pricing using floating net asset value (FNAV), investors are better able to evaluate institutional funds. Investors should also realize there is a lower incentive to redeem their shares ahead of others, particularly during period of financial stress, due to new liquidity fees and gates that may be in place.

What is a redemption gate?

A fund's Board of Directors may elect to put in place a limit on the amount of redemptions from a fund during a specified period of time. This period cannot exceed 10 (business) days out of a 90 day period. The purpose of a redemption gate is to prevent a run on the fund during periods of financial stress.

What is a liquidity fee?

Investors may face a fee of up to 2% of their share value to redeem their holdings in a money market fund during periods of financial stress. This fee may be levied by the Board of Directors in an effort to pass the costs associated with raising liquidity to the investor choosing to leave the fund, rather than be absorbed by the remaining shareholders.

When can a fund's Board of Directors implement liquidity fees and/or redemption gates?

When a fund's weekly liquidity falls below 30%, the Board of Directors has the **discretion** to introduce fees and or/gates if it is in the fund's **best interests**.

When a fund's weekly liquidity falls below 10%, the Board of Directors is **required** to implement a 1% redemption fee (unless the Board votes to implement a different fee ranging from 0-2%). Again, the Board of Directors must act in the shareholder's best interests.

When must a fund's Board of Directors remove liquidity fees and/or redemption gates?

When a fund's weekly liquidity exceeds 30%, the Board of Directors must remove fees and/or gates. Note: Gating is always discretionary, whereas fees may be required based on a fund's current liquidity.

How can an investor review a fund's weekly liquidity threshold?

According to a new requirement for fund sponsors, a fund's liquidity must be published daily on the fund's website.



What is the difference between institutional, retail, and government money market funds?

A government money market fund is defined as a fund that invests at least 99.5% of its total assets in cash and government securities. Government money market funds are an exception to the new reforms. These funds are exempt from the FNAV rules, which means government funds will maintain a stable \$1 NAV on their underlying securities. Government funds are also not subject to liquidity fees and gates.

Retail funds are primarily held by “natural persons” (individuals) and sold through an intermediary. Like government funds, retail funds are exempt from FNAV rules, although subject to potential liquidity fees and gates.

All other funds not classified as government funds or retail funds are classified as institutional funds. Institutional money market funds are primarily held by a business, pension plan, endowment, or other institutional investor, although they can be offered to individuals through institutional share classes. Institutional funds enforce the FNAV rules based on underlying market values. Like retail funds, institutional funds are also subject to liquidity fees and gates.

