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U.S. Money Market Fund Reform Overview

UPDATE: MARCH 2016

On July 23, 2014, the Securities and Exchange Commission (SEC) adopted amendments to the rules that govern money market funds (MMFs) to address risks of investor runs in such funds, while still preserving the funds' benefits. The reforms change the way MMFs operate in an attempt to reduce their susceptibility to heavy redemptions during times of stress, as well as increase the transparency of MMF risk, without negating the benefits currently afforded by MMFs. Key structural changes to MMFs include:

- **New distinctions between "retail" and "institutional" prime and tax-exempt MMFs**, which will limit who can invest in these types of MMFs
- **Imposition of floating net asset value (NAV) share pricing on institutional prime and institutional tax-exempt MMFs**, which will require share prices of these fund types to increase or decrease along with the underlying value of the fund's assets, or "float," as opposed to maintaining a stable $1.00 per share price
- **New rules for liquidity fees and redemption gates**, which may impact an investor's ability to redeem shares, particularly in prime and tax-exempt MMFs

The implementation date of various amendments is staggered; however, the reforms that will impact prime and tax-exempt MMFs (retail vs. institutional distinction, floating NAV, liquidity fees, and redemption gates) will go into effect on October 14, 2016. These features will not apply to U.S. government MMFs and U.S. Treasury MMFs (see table below).

Wilmington Trust continues to assess the impact of the new rules and will communicate relevant information to help you determine what actions, if any, may be necessary based on your specific needs and circumstances.

FIGURE 1:
Changes to take effect on October 14, 2016

Fund type	Floating net asset value (NAV)	Liquidity fee/redemption gate
U.S. Treasury		
U.S. government		
Retail tax-exempt		X
Retail prime		X
Institutional tax-exempt	X	X
Institutional prime	X	X

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Retail and institutional money market funds

NEW DISTINCTION

Definition

Currently, a retail fund is classified as such by the fund's advisor, is primarily offered to individuals with moderate-size accounts, and has relatively low initial investment minimum requirements. Institutional investors are not currently restricted from investing in retail MMFs.

Effective October 14, 2016, a retail MMF will be defined as one that has policies and procedures reasonably designed to limit "beneficial owners" of the fund to natural persons—i.e., human beings, as opposed to entities—or any account type whereby the end investor is a natural person. Further, beneficial owners typically mean those having voting and/or investment power in the fund's shares. Institutional investors will be restricted from investing in retail MMFs.

What is happening?

The SEC is imposing new definitions for retail and institutional funds, which may differ from how fund advisors currently use these terms. Under the amended rules, only natural persons or accounts in which the beneficial owner meets the MMF definition of a natural person will be able to invest in retail funds. Institutional investors will be restricted from investing in retail funds. This retail vs. institutional fund distinction is critical as it will determine eligibility of an investor for a particular fund and whether such fund will adopt the new structural and operational features (see table on prior page). Wilmington Trust is working to identify which clients will be classified as retail or institutional based on the SEC's guidance in order to ensure compliance with Money Market Fund Reform.

What is changing?

Today, an institutional investor may invest in retail MMFs. By October 14, 2016, this will no longer be the case. Retail funds will be limited to account types where the beneficial owner, as defined in the MMF reform, is a natural person. However, retail investors will still be able to invest in institutional MMFs if they so desire.

In addition, starting on October 14, 2016, a prime and tax-exempt MMF's initial investment minimum requirement will no longer govern whether a MMF is classified as retail or institutional (as frequently occurs today).

Floating NAV

NEW SHARE PRICING METHODOLOGY

Definition

A floating NAV is a given fund's price per share calculated by valuing portfolio instruments at their present market value. Historically, MMFs have been allowed to price and transact at a stable NAV share price of $1.00 per share.

What is happening?

Under the new rules, institutional prime and institutional tax-exempt MMFs will be required to price and transact at a floating NAV based on the market-based values of their portfolio securities, instead of a stable $1.00 per-share price. MMF shares will also be priced using a more precise valuation method of basis point rounding to the fourth decimal place (e.g. $1.0000). The requirement will likely result in the daily share prices of MMFs fluctuating along with changes in the market-based value of the funds' investments.

What is changing?

Under present-day rules, all MMFs seek to maintain a daily fixed NAV or stable share price by using "penny rounding" to the nearest penny ($1.00). By October 14, 2016, institutional prime and institutional tax-exempt MMFs will be required to transact at a floating NAV for sales and redemptions.

Liquidity fees and redemption gates

NEW TOOLS FOR FUNDS' BOARDS

Definition

A liquidity fee is a fee that could be imposed on investors for redeeming MMF shares. Liquidity fees are levied during times of stress, when investors often are more inclined to want to redeem shares. Investors maintain continued access to their liquidity but at a cost, which may serve to temper shareholder desire to redeem shares.

A redemption gate is a temporary halt on redemptions, thus preventing investors from redeeming shares in a MMF for up to 10 business days in a 90-day period.

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What is happening?

Under the new rules, liquidity fees and redemption gates could apply to prime and tax-exempt MMFs (retail and institutional) under the following circumstances:

- If weekly liquid assets fall below 30% of a MMF's total assets, the fund's board would be permitted to impose either:
  - Up to a 2% liquidity fee on redemptions
  - A redemption gate, suspending redemptions for up to 10 business days
- If weekly liquid assets fall below 10% of a MMF's total assets, the fund's board would be required to impose a 1% liquidity fee on redemptions.[1]

Amendments addressing transparency require funds to disclose on their websites, on a daily basis: levels of daily and weekly liquid assets, imposition of fees and gates, and other data.

Liquidity fees and redemption gates will not apply to U.S. government and U.S. Treasury MMFs.[2]

What is changing?

Today, MMFs are not required to impose a fee on investors to redeem shares (liquidity fees). However, on a very limited basis, they can impose gates which temporarily suspend an investor's right to redeem shares (redemption gates).[3] Starting on October 14, 2016 prime and tax-exempt funds may be required to impose liquidity fees or redemption gates under certain specific circumstances.

Wilmington Trust will continue to monitor industry developments, communicate relevant updates and information, as well as provide guidance to help you determine what actions, if any, may be necessary based on your specific needs and circumstances.

[1] N.B.: At the fund board's discretion, it may impose a different fee or no fee. The liquidity fee is imposed only if the MMF's board determines that such a fee is in the best interests of the fund.

[2] At the fund board's discretion, it may choose to opt in to the ability to impose liquidity fees or redemption gates on U.S. government and U.S. Treasury MMFs, but U.S. government and U.S. Treasury MMFs are not required to do so as part of the reform.

[3] According to the 2010 money market fund reforms (Rule 22e-3), under certain circumstances, MMFs are permitted to suspend redemptions and postpone payment of redemption proceeds during an orderly liquidation.

If you have questions regarding your investments or the upcoming regulatory changes described in this document, please contact your relationship manager.

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