SEC APPROVES CHANGES TO MONEY MARKET FUNDS

What you need to know about recent action by the U.S. Securities and Exchange Commission (SEC).

July 23, 2014

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Today, the SEC provided a final ruling on money market mutual fund reforms – and the money market fund landscape is about to undergo sweeping changes.

During their much-anticipated July 23 open meeting, the Commissioners' comments and subsequent 3-2 vote in favor of changing certain rules governing Rule 2a-7 money market funds offered few surprises. Key changes adopted include:

- **Floating NAV.** Certain institutional money market funds must transition from a constant NAV (cNAV) structure to a variable NAV (vNAV) structure.
- **Liquidity fees and redemption restrictions** will apply to all money market funds, excluding government funds.

2-Year Compliance Timeline: The compliance date for the vNAV amendments, as well as for the liquidity fees and redemption restrictions, will be 2 years after the final rule is published in the Federal Register.

In an effort to aid your understanding of the SEC's decision – and to help you prepare for the new regulations – we've compiled this overview of the approved changes. As one of the industry's largest money managers, we remain committed to the cash business and have long anticipated this final ruling. We are fully prepared to comply with all the operational implications within the stated timeframe.

THE AMENDMENTS: A SYNOPSIS

The approved amendments, originally proposed in response to the financial crisis, are intended to protect investors – by drastically reducing the likelihood of "runs" on regulated money market mutual funds while maintaining the viability of these important investment vehicles.

The most significant change will affect institutional prime and tax-exempt money market funds, but retail money market funds will be subject to a few changes governing liquidity fees and redemption restrictions. See chart below for a summary of how funds are affected:

	Institutional			***Retail***		
	Government	*Tax-Exempt*	*Prime*	*Government*	*Tax-Exempt*	*Prime*
Transition from cNAV to vNAV		X	X			
Liquidity fees & redemption gates		X	X		X	X

The SEC adopted the following structural changes for Rule 2a-7 money market funds:

- **Floating NAV**. Institutional prime and tax-exempt money funds must shift from the current constant net asset value (cNAV) pricing standard to a floating, or variable, net asset value (vNAV) standard. This transition must be complete within the 2-year timeline.
- **Liquidity Fees and Redemption Restrictions.** The amended rule introduces liquidity fees and redemption restrictions that restrict how much a shareholder in any non-government money market fund – whether institutional or retail – can access once the fund's Board, at its discretion, chooses to impose liquidity fees or redemption "gates." Simply put: the fund's Board of Directors ultimately must determine if the restrictions are necessary and can decide to not impose the restrictions if they decide doing so is not be in the best interest of the fund.
- **Additional Requirements: New Disclosures.** This rule change imposes enhanced disclosure requirements that require money fund sponsors to report their funds' daily and weekly liquidity levels, daily NAV, portfolio holdings and support status. Additional reporting, enhanced diversification and stress testing requirements have also been adopted. **Note:** Funds must comply with the rules affecting disclosures within 18 months of the final rules' publication in the Federal Register.

The commissioners also provided additional clarification around the definition of a retail money market fund and guidance on important tax and accounting implications, which we discuss in greater detail under "Tax Implications", page 3.

Not All Money Funds Subject to Same Rules

The SEC has made some important distinctions that affect the application of these rule changes to money funds.

Exemptions from Structural Rule Changes

- **Government Money Market Funds.** Defined by the SEC as those funds that hold a minimum of 99.5% of assets in government securities, repo collateralized by government securities, or cash.
- **Retail Money Market Funds.** Defined by the SEC as those funds that adopt a standard based on whether the beneficial owner represents a natural person, are exempt from the vNAV requirement but not exempted from liquidity fees and redemption gates.

Funds Subject to vNAV Rule Changes

- **Institutional Prime Money Market Funds**
- **Institutional Tax-Exempt Municipal Money Market Funds**

Funds Subject to Liquidity Fees and Redemption Restrictions

- **Non-Government Institutional Money Market Funds**
- **Non-Government Retail Money Market Funds**

Deeper Look: Certain Funds to Experience Greatest Change

As noted above, institutional prime and tax-exempt money funds are required to operate with a floating, or "variable," NAV (vNAV). In practice, this means the vNAV must be rounded to the fourth decimal place (e.g., $1.0000). In addition, both institutional and retail non-government money market funds are required to impose a host of restrictions, including:

- **Liquidity Fees (up to 2%) -** If weekly liquid assets fall below 30%, the fund may impose a liquidity fee of up to 2%.
- **Liquidity Fees (1%) –** If weekly liquid assets fall below 10%, the fund must impose a liquidity fee of 1% on redemptions.
- **Redemption Restrictions (Redemption Gates) –** If the level of weekly liquid assets falls below 30%, the Board may also temporarily suspend redemptions if it believes doing so is in the best interest in the fund.

The Board can also, at its discretion, choose to lower or raise the liquidity fee (up to 2%) it imposes on redemptions.

For example, during times of market illiquidity, if a fund's weekly liquid assets fall below 30% of its total assets, the fund can impose a 2% liquidity fee on all redemptions – unless the fund's Board determines such a fee is not in the best interest of the fund. Moreover, under such circumstances, a money fund's Board could temporarily suspend redemptions for a limited period (up to 10 days).

Tax Implications: Additional SEC Guidance

The SEC noted the U.S. Treasury and IRS will issue new rules to alleviate the tax burdens vNAV funds might experience due to new requirements associated with tracking individual purchase and sale transactions.

Additionally, the SEC recommends that floating NAV money market funds, which are subject to fees and redemption restrictions, should continue to qualify as "cash equivalents."

To read the related press release from the Securities and Exchange Commission, click here or paste this link into your browser: http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679#.U8_0RfldU9k.

Northern Trust's View: Implications for Investors

We have been closely following the discussions around money market reform for some time, and we anticipated this week's announcement. In preparation for the 2016 implementation date set forth by the SEC, we continue to assess the features of our products and services in this space, and will make adjustments as appropriate. We have begun further analysis of the announced changes and will provide you with our insights into likely implications in the coming weeks, once the final draft of the new rules are publicly available.

As one of the largest cash managers, managing approximately $215 billion in liquidity assets, we remain committed to our cash management business – and to adopting best practices for the new money market reforms that enhance transparency for our investors. Our investment and economic experts continually monitor regulatory proposals and changes, and the evolving investment landscape, in order to offer fresh insights and help our clients take advantage of market opportunities.

What You Can Do Today

The time is right to revisit your cash strategy now – to Rethink Cash – in order to boost the yield on your short-term investments.

For more information on Northern Trust's thinking on cash and short duration investing, please refer to these helpful resources:

- **Interest Rates "Lower for Longer"** Cash investors often see lost opportunities with a wait-and-see approach for rising interest rates.
  Read "Waiting for Interest Rates to Change Could Prove Costly"

- **Balancing Yield and Risk.** A cash segmentation strategy can help investors increase the yield and incremental returns of their cash portfolios while maintaining an appropriate level of risk.
  Read "Balancing Yield and Risk with an Ultra-Short Strategy"

- **Rethinking Cash Portfolios** A segmentation strategy can help institutional investors boost the yield of their short-term investment portfolio.
  Read "Rethinking Cash Portfolios"

- **MarketScape with Colin Roberston** State of the Market: Fixed Income Still Going Strong (May 5, 2014).
  Watch the video

- **Ultra-Short Duration.** An ultra-short strategy can provide increased returns while managing principal volatility.
  Read "Adding Value with Ultra-Short Fixed Income"