

ICI VIEWPOINTS

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For Money Market Funds, Massive Preparation Has Paid Off in Smooth Transition

By Marty Burns

First in a series on money market funds.

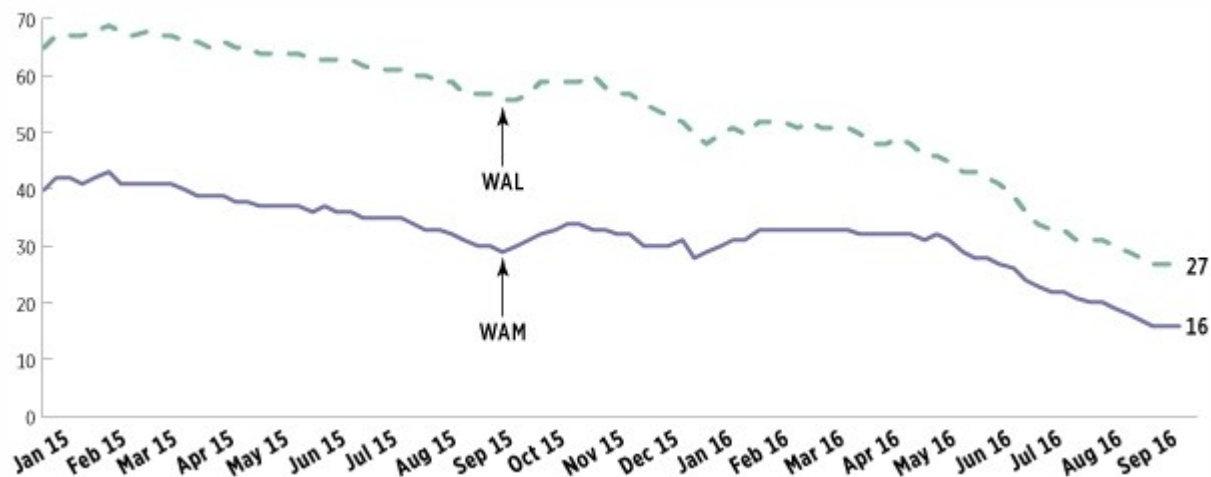
By October 14, the money market fund industry must fully implement the 2014 money market fund reforms passed by the Securities and Exchange Commission (SEC), cementing major changes for investors and fund complexes. ICI has been in close constant contact with members since the rules were enacted in 2014 and has been working with operations and other professionals throughout the industry to ensure an orderly transition—including fully informing investors—to the new regime in October.

Throughout this time, funds have been actively creating and testing new systems and tools to implement requirements under the new rule. The upcoming changes have led to significant shifts in money market fund assets. These shifts were anticipated, and the thoughtful planning by industry leaders has helped to smoothly manage the \$910 billion in money market fund asset flows we have seen to date. At ICI, we believe the industry is well positioned to navigate the remaining fluctuations as the new rules take hold.

To ensure a smooth transition to the new regime, money market funds have been beefing up their liquidity, investing predominantly in securities with very short maturities. Data on the weighted average maturity (WAM) and weighted average life (WAL) of money market fund holdings show a significant shortening in each category (see chart). With shorter maturities, funds will have ample liquidity to accommodate high levels of outflows before and after October 14.

WAMs and WALs of Prime Money Market Funds Are at All-Time Lows

Number of days; weekly, January 6, 2015–September 20, 2016



Source: iMoneyNet

Summary of the New Money Market Fund Rules

The 2014 SEC rules largely centered around two principal reforms. The first reform requires prime institutional and tax-exempt institutional money market funds to price and transact in their shares using “floating” net asset values (NAVs).

The second principal reform will enable, and in certain cases require, all nongovernment money market funds (i.e., all prime and tax-exempt funds, whether institutional or retail) to impose barriers on redemptions (so-called liquidity fees and gates) during extraordinary circumstances, subject to determinations by a money market fund’s board of directors.

These are significant structural changes that require considerable planning and testing to implement. Here’s a look at what funds have been doing recently to smooth the transition to the new rules.

Funds Are Working Toward Smooth Implementation

For more than two years now, operations, investment, and legal professionals in fund complexes across the United States have been working steadily to implement the SEC’s new rules. ICI has helped coordinate important work streams addressing implementation issues in the following areas:

- Identifying retail versus institutional investors
- Preparing funds to float their NAVs, including calculating NAVs to four decimal places

- Preparing for intraday processing for floating NAV money market funds
- Enabling funds to impose liquidity fees and redemption gates

Each of these work streams requires a different area of focus and expertise, so here's more detail about each stream and what it means for investors.

Retail vs. institutional investors

The 2014 reforms require that sponsors choosing to offer retail funds separate their prime and tax-exempt money market funds into two categories: retail funds, which can only be owned by natural persons, and institutional funds, open to businesses and all other investors. Pursuant to the new rules, fund complexes have been sorting through their shareholder files to make sure each investor is enrolled in the appropriate fund. This can require multiple steps and consistent monitoring, particularly because money market fund shareholders often invest through broker-dealers or other intermediaries that may operate omnibus accounts that pool the holdings of many investors.

Sponsors choosing to offer retail funds have been implementing policies and procedures that are reasonably designed to ensure that only natural persons (i.e., human beings, not businesses or organizations) own retail shares. These procedures could include prospectus disclosures and steps to clarify the role that broker-dealers or other intermediaries play. To help funds facilitate these decisions and implement the required changes, ICI published an [Annotated Prototype Policy and Procedures for Retail Money Market Funds](#), which also serves as a handy resource to learn more about this aspect of the new SEC rules.

Preparing funds to float, including calculating NAVs to four decimal places

Before the reforms, a key characteristic of money market funds was the stable \$1.00 NAV. Funds were managed, and were allowed to use specific pricing rules, so that they could consistently offer and redeem shares for \$1.00. Under the new reforms, however, prime and tax-exempt institutional money market funds will be required to calculate "floating" share prices based on the market value of portfolio holdings at the time they strike their NAV. The new rules also require funds to calculate their NAVs to four decimal places. (For a fund with a NAV of \$1.00, that means calculating the NAV to one-hundredth of a penny—i.e., \$1.0000.)

To realize this change, fund operations teams have been busy working with pricing vendors and reprogramming and testing system algorithms that calculate NAVs to ensure they are working in an accurate, reliable manner. For many, this means a large-scale reconfiguration of complex systems that were previously not designed for this level of precision. By all accounts, this highly technical work and testing has succeeded and firms are prepared to meet the demand for unprecedented levels of precision on the valuation of floating NAV money market funds.

Preparing for intraday processing for floating NAV money market funds

Under the new rules, some money market funds may choose to calculate (or “strike”) their NAV multiple times a day. This would allow a floating NAV fund to maintain its role as a cash management vehicle by ensuring that investors have intraday access to their balances.

Funds may decide whether to strike multiple NAVs and when during the day to do so. Many funds have indicated they are planning to strike two to three NAVs per day, typically in the morning, around midday, and in the afternoon before the markets close.

To do this, funds are enhancing systems, educating shareholders, and updating their prospectuses and other materials about the upcoming changes.

Enabling funds to impose liquidity fees and gates

The new SEC rules will require all nongovernment money market funds (i.e., all prime and tax-exempt money market funds, whether retail or institutional) to have the ability to impose liquidity fees, redemption delays (“gates”), or both to slow redemptions under extraordinary circumstances.

The new rules give a money market fund’s board the flexibility to impose liquidity fees of up to 2 percent, redemption gates (a delay in processing redemptions for up to 10 business days), or both if the fund’s weekly liquid assets have dropped below 30 percent of its total assets.

If a fund’s weekly liquid assets fall below 10 percent of its total assets, the SEC rules require the fund to charge redeeming investors a fee of 1 percent of their redemption, unless the fund’s board determines either that no fee, or a lower or higher fee (not to exceed 2 percent), would be in the best interests of the fund.

This is a major change for money market funds. In ICI’s discussions with members about the transition to the new rules, it is clear that the fees and gates requirement has proven to be a larger concern to investors than policymakers originally anticipated. Funds have spent a considerable amount of time communicating around fees and gates to shareholders, including making the point that sponsors believe it is extremely unlikely that they would ever choose or be forced to impose fees and gates.

What Does This Mean for Investors?

What do all of the upcoming changes and recent work by fund companies mean for millions of shareholders who invest in money market funds? It means the fund industry is well positioned to meet investor demand and market conditions surrounding the rules change. Yes, the pending change has already had a significant impact on the flow of investor assets—out of prime and into government money market funds. But this shift was anticipated and fund companies took the necessary steps to communicate and adjust portfolios to manage the change without disruption. We expect this preparation to continue to pay off as we approach—and pass—the October 14 implementation date.

Throughout this transition, ICI has been tracking the data and [writing](#) about developments in the market. For more information on the upcoming rules change and funds' efforts to meet the new requirements, please visit [ICI's Money Market Fund Implementation Resource Center](#).

More Posts in This Series

- [For Money Market Funds, Massive Preparation Has Paid Off in Smooth Transition](#)
- [As Money Market Fund Investors Adjust, Funds Have Managed Flows](#)
- [Money Market Fund Reforms Combine with Bank Regulations to Boost Interest Rates](#)

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