INDEPENDENT DIRECTORS COUNCIL

Money Market Fund Reforms and New Board Responsibilities

IDC Webinar

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Panelists

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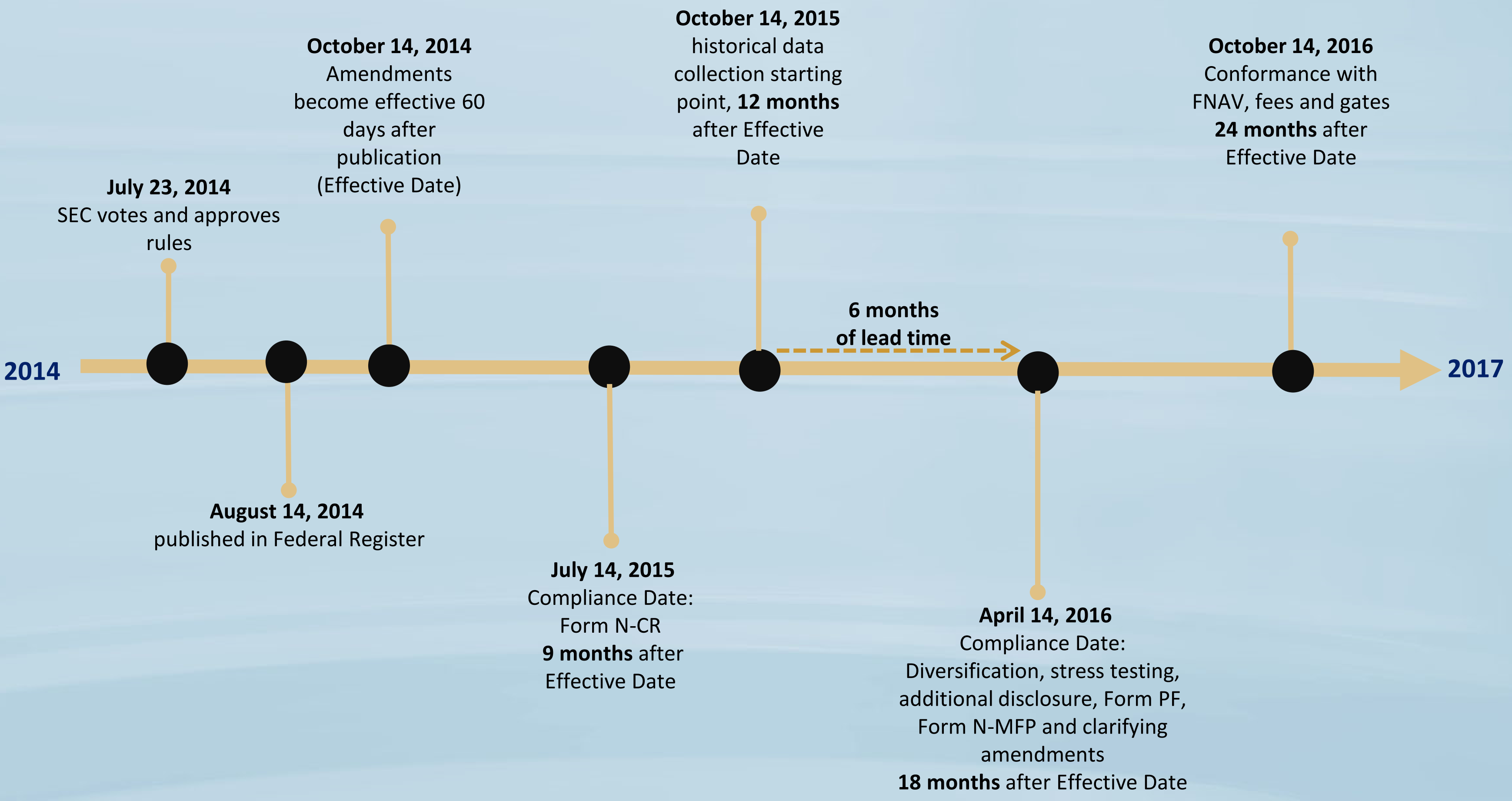
Money Market Fund Reforms and New Board Responsibilities: Agenda

- Structural changes and new products
- Valuation guidance
- Liquidity fees and redemption gates
- Stress testing, diversification, and disclosure

Compliance Timeline



Features of Different Types of MMFs

Feature	Gov't	Retail	Institutional Prime
99.5% Government Securities and Cash	✓		
Limited to Natural Persons		✓	
Fluctuating NAV			✓
Stable NAV	✓	✓	
Liquidity Fees and Gates	Optional	✓	✓

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Alternatives to Money Market Funds

- Private Money Market Funds
  - Can maintain a stable value
  - Limited to Qualified Purchasers/Accredited Investors
  - Partnership Taxation
- Ultra-short Mutual Funds
  - Shorter WAMs than current ultra-short funds
  - Only rounds to three digits (e.g. $1.000 or $10.00)
  - Cannot be held out as a money fund equivalent
  - Would not benefit from tax or confirmation relief

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Transitional Issues

- Other than government funds, existing money market funds must choose
  - Whether to become a retail or institutional fund
  - If retail, how to remove shareholders that are not natural persons
- SEC provided exemptions for reorganizing institutional and retail classes into separate funds
  - Directors must determine that any reorganization results in a fair and approximately pro rata allocation of the fund's assets
  - A reorganization may require a shareholder meeting

Considerations for Directors of Government Money Market Funds

- Policy of investing at least 99.5% of total assets in cash, government securities and repurchase agreements collateralized fully by government securities
  - Does not have to be a fundamental policy
  - May already be the fund’s investment strategy
- Whether to rely on liquidity fees and gates
  - As treasury securities and many agency discount notes are weekly liquid assets (WLA), hard to see a benefit

Considerations for Directors of Retail Money Market Funds

- Adoption of policies and procedures reasonably designed to limit all beneficial owners to natural persons
  - Indicia of natural persons include SSN or an account type limited to natural persons (such as a 401(k) or college savings account)
  - Procedures must be reasonable, not perfect; an accidental institutional shareholder is not fatal
- Should be incorporated into Rule 38a-1 process

Intermediaries and Retail Money Market Funds

- Intermediaries must abide by policies and procedures
- SEC said: "Funds may manage these relations in the manner that best suits their circumstances"
- Examples
  - Contractual arrangements
  - Periodic certifications by intermediary

Considerations for Directors of Institutional Prime Funds

- Institutional prime funds must calculate their NAV per share like other mutual funds, but rounded to the nearest basis point (e.g., $1.0000)
- Existing valuation procedures may apply, including
  - Fair valuing maturities of 60 days or less at amortized cost
  - Fair valuing other securities using pricing services
- Challenge if institutional prime fund will price at multiple times during each day

Valuation Guidance—Amortized Cost

- Board cannot delegate determination of fair value
- Directors may continue to use amortized cost as fair value for securities with remaining maturities of 60-days or less, if
  - Market quotations are not readily available
  - Amortized cost approximates market-based value each time NAV is calculated
  - Existing credit, liquidity, or interest rate conditions and issuer specific circumstances are taken into account

Valuation Guidance—Pricing Services

- Maturities greater than 60 days may be fair valued using evaluated prices from pricing services
- Board "may want to consider"
  - Inputs, methods, models and assumptions used by the pricing service
  - The quality of the pricing service's evaluated prices
  - Any difference between the time as of which the pricing service evaluates pricing and the fund's NAV calculation

Liquidity Fees and Gates—Procedural Issues

- Monitoring liquidity is similar to monitoring shadow price
  - Daily measurement against a threshold (30% and 10% rather than ½¢)
  - Imposing a liquidity fee or gate should be as rare as breaking a dollar, and consequences may be the same
  - Important to try to stay ahead of any problem and to identify who is in charge
- Daily and weekly liquid assets and shadow price will be publicly available on a daily basis

Restrictions on Directors regarding Liquidity Fees and Gates

- Board cannot delegate power to impose liquidity fees or gates
- SEC said: "A blanket decision on the part of a fund board to not impose fees or gates, without any knowledge or consideration of the particular circumstances of a fund at a given time, would be flatly inconsistent with the fees and gates amendments"

When Is Board Required to Consider Liquidity Fees or Gates?

- Rule 2a-7 does not require a meeting; however:
  - If WLA is below 10% at the end of the day and the Board does not meet, the fund must impose the default liquidity fee
  - "[The SEC] believe[s] that when a fund falls below 10% weekly liquid assets, its liquidity is sufficiently stressed that its board should be required to consider, based on the facts and circumstances at that time, what, if any, action should be taken to address a fund's liquidity."
- Board has more latitude when WLA is below 30% but still above 10%

Factors to Consider When Imposing Liquidity Fee or Gate

- Relevant indicators of liquidity stress in the markets
- Why WLA has fallen
- Liquidity profile of the fund and expectations as to how profile might change
- Make-up of the fund's shareholder base
- Previous shareholder redemption patterns
- Prior experience with the imposition of liquidity fees and gates
- For retail and government MMFs, whether the shadow price has also declined

Factors to Consider When Setting Liquidity Fee

- Changes in spreads for portfolio securities
- Maturity of the fund's portfolio securities
- Changes in the liquidity profile of the fund in response to redemptions and expectations as to how profile might change
- Prior experience with the imposition of liquidity fees
- Whether the fund and its intermediaries are capable of imposing a different liquidity fee from the default liquidity fee
- For institutional prime funds, the extent to which the NAV already reflects liquidity costs

Intermediaries and Liquidity Fees & Gates

- Intermediaries must be able to implement any liquidity fee or gate imposed by the board
- Issues
  - Automated transaction systems (such as sweeps)
  - Communication of liquidity fee or gate to intermediaries and shareholders
  - Capacity to vary liquidity fee from day to day
  - Variation among funds
  - Checks and debit cards

Director Responsibilities after Imposing a Liquidity Fee or Gate

- Must remove liquidity fee or gate once WLA > 30%
- Must remove gate after 10 business days
- SEC expects board to monitor whether a liquidity fee or gate continues to be in the best interests of the fund
  - Liquidity fee or gate may be imposed, modified or removed at a telephonic meeting of the board

Contingency Planning for Liquidity Fees and Gates

- Consider discussing in advance the processes for determining whether to impose a liquidity fee or gate and for implementing a fee or gate
- Topics include:
  - Probable market/industry conditions
  - Warning signs
  - Roles of various parties (i.e., adviser, transfer agent, board, board counsel, and other service providers)
  - Who will call a meeting
- Will be pertinent to prospectus disclosure

Changes to Standard Stress Tests

- Must test ability to maintain 10% of total assets in WLA
- Institutional prime fund must test ability to minimize NAV volatility
- Test events must be combined with increasing levels of shareholder redemptions
- Increases in interest rates for various sectors must be tested

Changes to Test Reporting & Additional Testing

- Other combinations of events adviser considers relevant must be tested
- Reports of stress test results to the board must include:
  - Summary of significant assumptions
  - Information to allow directors to evaluate results
  - Still requires adviser's assessment of ability to withstand the events that are reasonably likely to occur within the following year

New Form N-CR

- A MMF must file a Form N-CR reporting–
  - A default or event of insolvency affecting more than 0.5% of total assets
  - Provision of financial support by the sponsor
  - A government or retail MMF's shadow price falling to 99.75 cents
  - WLA < 10% of total assets at the end of a business day (unless a government MMF)
  - Imposition or removal of a liquidity fee or gate
- N-CR is publicly available when filed

Impact of N-CR on Directors

- Must include a “brief discussion of the primary considerations or factors taken into account by the board” in imposing a liquidity fee or gate or not imposing a fee after WLA falls below 10%
- Not required to report a sponsor payment if the board determines the payment was not “reasonably intended to increase or stabilize the value or liquidity of the fund’s portfolio”
- Publicity—N-CR will alert the press

Updated Compliance Procedures and Disclosure

- Diversification
  - Parent and majority owned subsidiaries treated as one issuer
  - ABS sponsors deemed guarantors
  - 15% basket for tax exempt funds and no basket for taxable funds
- Daily website disclosure of past six months'
  - % of Daily and weekly liquid assets
  - Flows
  - Shadow NAV
- Registration statements must be amended to correspond to type of fund (e.g., natural person limit, liquidity fees and gates)

Examples of Key Adviser-Board Discussion Items

- Plans for new fund line-up
  - Money market funds—government, retail, institutional prime
  - Alternatives to money market funds
- Process for transitioning to new fund line-up
  - Transitioning to retail or institutional fund
  - Reorganization considerations – fairness
  - Determine whether shareholder vote is required
  - Role of intermediaries

Examples of Key Adviser-Board Discussion Items

- Approving fund policies
  - Government funds—99.5% requirement; whether to rely on liquidity fees and gates
  - Retail funds—limiting to “natural persons”
  - Valuation policies for institutional prime funds and in light of guidance
  - Liquidity fees and redemption gates
  - Stress tests
  - Diversification