August 2014 – Summary Sheet from SGSS - Strategy & Market Infrastructure (SMI)

MONEY MARKET FUNDS IN U.S.

Text of reference: U.S. SEC Approves Sweeping Amendments to Rules Governing Money Market Funds - 23 July 2014 **Link:** http://www.sec.gov/rules/final/2014/33-9616.pdf

Description

Prompted by the SEC's failure to act on the 2012 Staff Proposals, on November 13, 2012, the U.S. Financial Stability Oversight Council (FSOC) issued proposed recommendations for action by the SEC under Section 120 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) (FSOC Recommendations).

The FSOC Recommendations included three alternatives: (1) **a floating NAV** (together with money funds pricing their shares at $100.00 as opposed to $1.00 per share); (2) **a stable NAV** subject to a capital buffer of up to 1% of a money fund's assets combined with a holdback requirement, or minimum balance at risk, applicable to certain redemptions for investors with account balances in excess of $100,000; and (3) **a stable NAV subject to a buffer of 3%**.

During the FSOC meeting at which the FSOC Recommendations were issued, several members of the FSOC expressed the view that the SEC should adopt its own set of reforms for money funds before the FSOC took further action.

The SEC received over 1,400 comments on the Proposing Release and, approximately one year after the Proposing Release was issued, **the SEC adopted the Amendments on July 23, 2014**.

The Amendments

<u>Liquidity Fees and Redemption Gates</u>

Liquidity fee of up to 2% for **non – government money fund** if weekly liquid assets falls below 30% of fund's assets

Redemption gates: Suspension of redemptions for up to 10 business days if level of liquid assets falls below 30%

A government money fund is not required to impose **liquidity fees** and **redemption gates.**

"**Weekly liquid assets**" include cash, U.S. Treasury securities, certain other government securities with remaining maturities of 60 days or less, securities that convert into cash within five business days and amounts receivable and due unconditionally within five business days pending sales of portfolio securities.

<u>Floating NAV</u>

Money funds are required to convert to a floating NAV. But government money funds and retail money funds are exempt from the requirement to convert to a floating NAV and may continue to use the amortized cost method of valuation.

A government money fund is defined as a money fund that invests 99.5% or more of its totals assets in cash, U.S. government securities and/or repurchase agreements "collateralized fully" in cash or government securities.

A "retail" money fund is defined as a money fund that "has policies and procedures reasonably designed to limit all beneficial owners of the fund to natural persons."

<u>Valuation Guidance</u>

The Amendments will continue to permit government money funds and retail money funds to use the **amortized cost method of valuation** and/or the penny rounding pricing method. In addition, an institutional prime money fund would be permitted to use amortized cost valuation to the same extent as other mutual funds – where the board determines, in good faith, that the fair value of debt securities with remaining maturities of 60 days or less is their amortized cost – unless particular circumstances, such as the impairment of the creditworthiness of an issuer or other factors, warrant otherwise.

The Adopting Release provided guidance with respect to amortized cost valuation, and stated that:

[The Commission] generally believe[s] that a fund may only use the amortized cost method to value a portfolio security with a remaining maturity of 60 days or less when it can reasonably conclude, at *each time* it makes a valuation determination, that the amortized cost value of the portfolio security is *approximately the same* as the fair value of the security as determined without the use of amortized cost valuation. Existing credit, liquidity, or interest rate conditions in the relevant markets and issuer specific circumstances at each such time should be taken into account in making such an evaluation.

Disclosure Requirements

Disclosure of Floating NAV, disclosure of Liquidity Fees and Redemption Gates, Prior Financial Support of Money Funds and Website Disclosure: as of the end of each business day during the preceding six months: (1) the percentage of its total assets invested in daily and weekly liquid assets; (2) its daily net inflows and outflows; and (3) its current NAV per share rounded to four decimal places (as well as the market-based NAV for stable NAV money funds).

Diversification

Amendments:

- require the grouping of affiliates of issuers in calculating the 5% issuer diversification limitation

- require each money fund to treat the sponsors of asset-backed securities (ABS) as guarantors unless the board of the money fund (or its delegate) makes certain determinations

- and remove the exception that allows 25% of a money's fund's portfolio to be subject to guarantee or demand features from a single institution.

Stress Testing Requirements

Specifically, money funds will now be required to periodically test both their ability to maintain weekly liquid assets of at least 10% and their ability to minimize principal volatility in response to specific hypothetical events. These hypothetical events include: (1) increases in short-term interest rates; (2) downgrades or defaults of specified portfolio security positions; and (3) widening spreads in various sectors.

Compliance dates

Floating NAV/Liquidity Fees and Gates requirements: Two years from the Effective Date

Diversification, Stress Testing and other Amendments: Nine Months from the Effective Date

Effective date= 60 days after publication in the Federal Register

Next steps

U.S. money fund managers will need to assess the impact of these amendments by putting in place a business plan to come into compliance.

In an article published in MoneyBeat on 18 Aug 2014, Fed Economists Criticize SEC Money- Fund Restrictions that the $ 2.6 trillion money-market mutual-fund industry in the U.S. will inadvertently encourage investor stampedes rather than quell them.

To know more:

- www.financialstabilityboard.org
- http://ec.europa.eu/internal_market/investment/money-market-funds/index_fr.htm
- Fact sheet on Money Market Funds

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