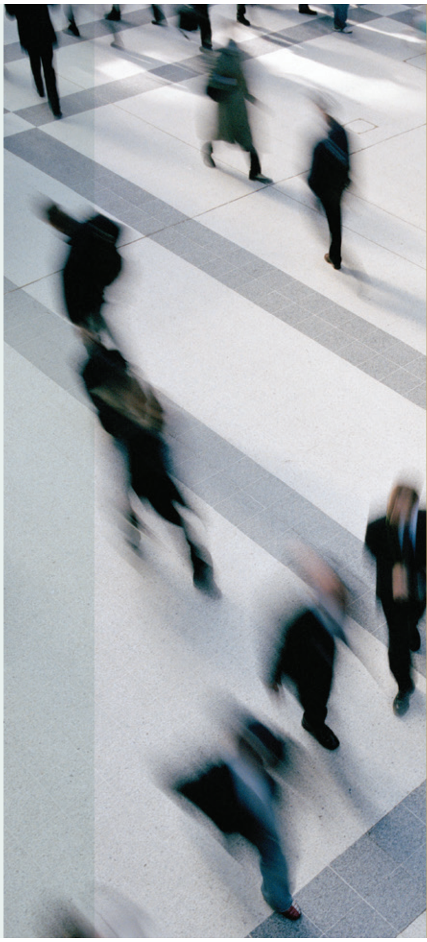

The Impacts of the Securities and Exchange Commission ("SEC") Adoption of Money Market Fund Reforms on Shareholder Servicing: Liquidity Fees and Redemption Gates

Part Two of Three

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As outlined in Part One of this series (see STA Newsletter, January 2015) the money market fund reform package adopted by the Securities and Exchange Commission (SEC) in 2014 has significant impact on the participants in the money market fund industry. From a shareholder servicing perspective, four reforms in particular will require money market fund transfer agents, and intermediaries, to design and implement solutions that involve enhancing systems and modifying operations processes. These reforms are: (1) Retail fund investor eligibility (see STA Newsletter, January 2015); (2) Liquidation fees; (3) Redemption gates; and (4) "Floating" net asset values ("NAVs") – the prices at which shareholders purchase and redeem their shares. The compliance dates for each of these particular reforms is October 14, 2016.

LIQUIDITY FEES AND REDEMPTION GATES

As part of the reforms, SEC Rule 2a-7 was amended to add two new tools to a fund's toolkit to use in times of stress to stem heavy redemptions – liquidity fees and redemption gates. While non-government money market funds will be expected to possess the ability to impose fees and gates, government money market funds may also voluntarily use these tools as well. Non-government money market funds will be required to possess the capability to impose and lift fees and gates by October 14 2016, which is the compliance date established by the SEC.

LIQUIDITY FEES

As permitted by these new reforms, a "liquidity fee" is a fee taken against redemption proceeds and retained by the fund. Such fees are intended be a disincentive for shareholders to redeem shares of a fund in distress, and also to help bolster the liquidity levels in a fund by infusing the fund with the cash withheld from redemption proceeds. After the October 14, 2016 compliance date established by the SEC, all non-government money market funds (including both institutional and retail funds) will be permitted to impose a liquidity fee of up to 2%, if weekly liquid assets fall below 30% of total assets and the fund's Board determines the fee to be in the best interest of the fund. Non-government money market funds will also be required to impose a 1% liquidity fee if weekly liquid assets fall below 10% of total assets, unless the Board determines that the imposition of such a fee is not in the best interest of the fund. Liquidity fees must be automatically lifted if the fund's weekly liquid assets reach or exceed 30%.

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Government money market funds may, but are not required to, use liquidity fees. There are no provisions for exemptions based on the type of shareholder account (e.g., ERISA accounts), the type of redemption (e.g., required minimum distributions on tax-advantaged accounts), or the amount of the redemption (e.g., low dollar value redemptions). Intermediaries holding omnibus accounts will be required to impose liquidity fees on subaccounts if the fund has imposed liquidity fees. The Board can impose a liquidity fee at any point during the day (an important point for institutional money market funds that will strike multiple NAVs in a business day).

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REDEMPTION GATES

A second method that funds may use to stem redemptions is to impose a "redemption gate", which is a temporary suspension of a shareholder's right to redeem shares of the fund. Redemption trades received when a fund is gated are to be rejected, rather than held until a gate is lifted. Non-government money market funds will be permitted to impose a redemption gate on up to 10 business days in a 90 day period, if weekly liquid assets fall below 30% of total assets. The gate would end if weekly liquid assets reach or exceed 30% of total assets. The decision to impose a redemption gate will be independent of a decision to impose a liquidity fee (therefore, a Board could choose to impose a fee, and at a later time decide to impose a gate).

Government money market funds may, but are not required to, use redemption gates. If a redemption gate is imposed, funds would reject redemption instructions that are received when a fund is gated. There are no provisions for exemptions based on the type of shareholder account, the type of redemption, or the amount of the redemption. Omnibus intermediaries are expected to impose redemption gates on subaccounts if the fund has gated redemptions. As with fees, gates may be imposed (or lifted) by the Board at any point during the business day.

COMMUNICATION CONSIDERATIONS

Perhaps one of the biggest challenges that fees and gates present is appropriate and effective communication between the money market fund, its transfer agent and intermediaries that sell the money market fund to the public. Some funds, such as certain institutional money market funds, may also want to inform their shareholders that a fee or gate is being imposed. Not only do the transfer agent and intermediaries need to know that a fee or gate has been imposed (or changed, or lifted), but they will need to know the timing of the fee or gate so that they can act in accordance with the fund board's direction. Also, it is very important that communications be timed so that no one gains a "first mover advantage" by acting on the knowledge that a fee or gate is being imposed before others receive or are able to respond to such news. Money market funds may want to consider developing a communication strategy ahead of time so that it can be "pulled off the shelf" in order to avoid confusion during what would likely be a very stressful time.

OPERATIONAL CONSIDERATIONS

Some mutual fund transfer agents will likely be able to leverage existing technology to develop the capability to charge liquidity fees and gate redemption transactions. Liquidity fees have many of the same characteristics as short term trader fees, which are fees imposed on market timers and retained by the fund. Similarly, transfer agents may be able to leverage existing "stop code" technology to reject redemption transactions. In addition to technology development that may need to be undertaken, transfer agents will need to review policies and procedures to address operational issues that may arise with the imposition of a fee or gate. These operational issues may be more acute in instances where a fee or gate is imposed during a business day, as opposed after the close of a business day. For example, transfer agents will need to know how to treat transactions that may have been received, but not yet reported to the fund, on a day where a fee or gate is imposed in the middle of the day.

The operational considerations related to transactions received by an intermediary present unique, and possibly more complex, challenges. For example, fees that are similar to liquidity fees are collected by intermediaries today, but are often remitted to the funds on a monthly or quarterly basis, whereas liquidity fees should be remitted on a daily basis.

If they have not already done so, money market funds may want to begin to discuss the treatment of fees and gates with their transfer agents and intermediaries soon. By clearly discussing communication strategies, system capabilities and limitations, and operational considerations, money market funds, their transfer agents, and intermediaries will be more likely to avoid pitfalls that might otherwise arise when trying to respond quickly and efficiently during a period of stress.

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