



The Impacts of the Securities and Exchange Commission (“SEC”) Adoption of Money Market Fund Reforms on Shareholder Servicing

Part One of Three

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Following their 2010 money market fund reforms, the SEC adopted a second round of reforms on July 23, 2014 to further address money market funds’ susceptibility to heavy redemptions, improve their ability to manage and mitigate potential contagion from such redemptions, and increase the transparency of their risks. These latest reforms have a significant impact on the participants in the money market fund industry, whether they are money market fund sponsors, service providers, intermediaries such as broker/dealers and banks, or the investing public. Among service providers, these reforms arguably have the greatest impact to money market fund transfer agents. This series of articles will specifically focus on how they will affect shareholder servicing.

From a shareholder servicing perspective, while there are many new requirements, 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. Compliance with these four reforms is voluntary for government money market funds and mandatory for other money market funds. These reforms are: (1) Retail fund investor eligibility; (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.

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GOVERNMENT MONEY MARKET FUNDS

From a transfer agent perspective, the SEC left government money market funds largely unchanged, as long as they meet portfolio holding thresholds. To be considered as a government money market fund, a money market fund must invest at least 99.5% of its total assets in cash, government securities, and or repos that are collateralized by cash or government securities. Government money market funds that meet these thresholds may continue to maintain stable NAVs (relying on amortized cost and penny rounding methods) for processing transactions. Also, government money market funds are not required to adhere to fee/gates provisions of the reforms, although they may voluntarily opt to impose fees/gates as if they were not government money market funds. “Muni” tax-exempt funds are not considered to be government money market funds, and therefore are treated as if they are “prime” money market funds.



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RETAIL FUND INVESTOR ELIGIBILITY

The rule defines a retail investor as a beneficial owner that is a natural person. ("Beneficial Ownership" typically means having voting power and/or investment power.) Money market funds that limit share ownership to retail investors may continue to maintain a stable NAV (may continue to use amortized cost and penny rounding methods.) Retail money market funds must have policies and procedures that are reasonably designed to ensure adherence to eligibility requirements, including ensuring that "omnibus account intermediaries" are enforcing such requirements for subaccounts. (Omnibus intermediaries are entities, such as broker/dealers, banks, and retirement plan recordkeepers that sell money market funds to the investing public, and maintain shareholder records themselves rather than transmitting individual account records to the money market funds' transfer agents.) Money market funds that do not limit eligibility to retail investors are considered to be institutional funds, and subject to both fees/gates and floating NAV requirements. Funds that have both institutional and retail classes today will be required to reorganize into separate funds.

As a general rule of thumb, a retail investor is an accountholder that has a social security number (SSN) as his or her tax identification number, and an institutional investor is an accountholder that has an employer identification number (EIN) as its tax identification number. However, as is often the case in developing regulatory solutions, the devil is in the details. It may be that certain accounts with EINs are beneficially owned by natural persons (for example, certain types of trusts). Therefore, money market funds, their transfer agents, and their omnibus intermediaries will need to come to a common ground with respect to the categorization of certain types of accounts that fall into the gray area. This need may prove problematic, particularly for omnibus intermediaries, because these intermediaries may need to support the categorization requirements for different money market funds that may not agree on whether a particular type of account should be considered to be owned by a retail investor or an institutional investor.

Another issue for money market fund sponsors, transfer agents, and omnibus intermediaries is what should be done with assets of institutional investors that are currently in retail money market funds when, on October 14, 2016, they are no longer permitted to be in these retail money market funds? Among the alternatives that many money market fund sponsors are considering is the establishment of new institutional money market funds to receive these institutional investors, the establishment of alternative products that are similar to money market funds but without the same compliance requirements, and directing these investors to a government money market fund. As for intermediaries, many are considering redirecting their customers' assets based on the product lineup established by fund sponsors. Money market fund sponsors and intermediaries are already working on developing initial estimates on the amount of assets held by institutional investors in retail funds, in order to better understand what the best solution may be. Once fund sponsors and intermediaries make these decisions, there will need to be a highly coordinated effort on the part of money market fund sponsors, their transfer agents, and intermediaries to transition institutional investors out of retail money market funds in an orderly fashion.

In subsequent editions of this newsletter, we intend to address the compliance requirements and impacts of the liquidation fees, redemption gates, and floating NAV requirements that are being imposed by the SEC.

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