
May 6, 2016

# SEC Money Market Reform:
# Effects and Considerations for the Changing Landscape

***From the Investment Team of PFM Asset Management LLC (PFMAM)***

In brief, on July 23, 2014, the Securities and Exchange Commission (SEC) adopted amendments to the rules governing money market funds (MMFs) registered under the Investment Company Act of 1940 Rule 2a-7. The most significant regulatory reforms impact the liquidity and accounting methodology of certain money market funds. These regulatory changes become final and effective on October 14, 2016.

| Amendment | Government Money Funds | Retail Money Funds | Prime & Municipal Institutional Funds |
|---|---|---|---|
| **Floating NAV** | No | No | Yes |
| **Liquidity Fees** | Not required | Yes | Yes |
| **Redemption Gates** | Not required | Yes | Yes |

**Liquidity Fees** — All non-governmental MMFs, including tax-exempt MMFs, are required to impose a "default" 1% liquidity fee on redemptions if a fund's weekly liquid assets fall below 10% of its total assets. Liquidity fees may also be imposed if weekly liquid assets fall below 30%, unless the Board determines otherwise. *The rule permits the Board of any MMF to impose liquidity fees.*

**Redemption Gates** — MMFs may temporarily impose redemption gates (i.e., suspend redemptions) for up to 10 business days if a fund's weekly liquid assets fall below 30% of its total assets, provided the Board determines that doing so would be in the best interest of the fund.

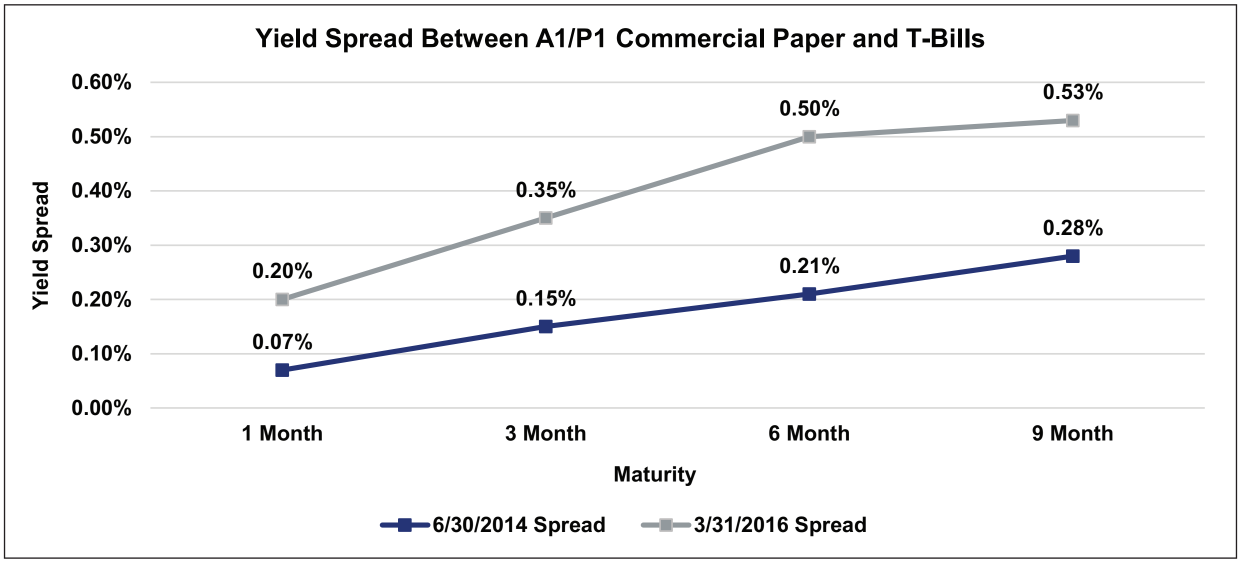
**Floating Net Asset Value (NAV)** — Prime (i.e., non-government), institutional MMFs will be required to operate with a floating, market-based NAV rounded to the fourth decimal place (e.g., $1.0004 or $0.9997).

As described below, the market has already experienced significant changes in advance of these new requirements.

**Industry Response and Short-Term Investment Options Going Forward**

Rather than take a "wait and see" approach, the market is reacting swiftly to these new rules. Many well-known providers of prime and tax-exempt MMFs have already taken steps to either convert their prime funds to government funds or have exited the business altogether. From March 31, 2014 to March 31, 2016, the number of MMFs has decreased by approximately 10 percent. As a result, institutional assets invested in prime MMFs have declined from $900 billion to $790 billion from November 2015 to March 2016. [1] Conversely, government MMF balances have experienced a modest increase, rising from $850 billion to just over $900 billion over that same period.[2] The shift to government funds is reducing demand for short-term corporate debt instruments and increasing the demand for short-term government securities. As indicated in the chart on the following page, the result is a widening in the yield differential or "spread" between those asset classes.

[1], [2] U.S. Securities and Exchange Commission, Division of Investment Management. (April 2016). Money Market Fund Statistics. Data as of March 31, 2016. Retrieved from https://www.sec.gov/divisions/investment/mmf-statistics/mmf-statistics-2016-3.pdf




*Source: Bloomberg.*

## Liquidity Management Solutions

Prime MMFs provide many benefits — including liquidity, diversification, and competitive yields — that investors are seeking to replicate through the use of available alternatives. As illustrated in the table below, each offers certain advantages and challenges. One possible approach is a combination of available options, such as utilizing a government MMF for daily liquidity, and a separately managed account for both liquidity and access to additional investment opportunities. Though this approach requires a higher level of coordination and oversight, it may best emulate the safety, liquidity, and yield offered by prime MMFs, while avoiding the pitfalls of potential liquidity fees and redemption gates stemming from regulatory changes effective in October.

| Short-Term Investment Options (Institutional) | | | | |
|---|---|---|---|---|
| | **Government Money Funds** | **Prime Money Funds** | **Bank Deposits** | **Separately Managed Accounts** |
| **Advantages** | • Liquidity<br>• Stable NAV<br>• Diversification<br>• Credit quality<br>• Ease of use | • Liquidity<br>• Competitive yield<br>• Diversification<br>• Credit quality<br>• Ease of use | • Liquidity<br>• Ease of use<br>• Earnings credit | • Customizable<br>• Liquidity<br>• Investment access<br>• Earnings potential<br>• Competitive fees |
| **Disadvantages** | • Lower yield<br>• Potential redemption gates & liquidity fees | • Redemption gates<br>• Liquidity fees<br>• Floating NAV | • Credit exposure<br>• Earnings potential<br>• Loss of excess earnings credits<br>• Bank demand<br>• Fees | • Initial set-up<br>• Additional accounting<br>• Custody relationship<br>• Cash flow management |

PFMAM can help you and your team evaluate the benefits, risks, and costs of your short-term investment options. We have 36 years of experience managing and advising on the investment of short-term, high-quality fixed-income securities. As of March 31, 2016 we managed more than $57.7 billion consisting primarily of short-term assets. We serve as a fiduciary and as a trusted advisor to our clients, and our ultimate goal is to help you craft a solution that best meets your organization's goals and objectives.