

Money Market Funds Under Fire



EDGE CAPITAL PARTNERS, LLC

Edge Capital Partners is an independent financial firm whose objective advice helps individuals and institutions realize their goals in the areas of investment management. The Edge Research Team's thoughtful and timely reports are based on extensive independent research and analysis of firms, financial developments, and macroeconomic trends.

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SEC Proposed Rule Changes

Money market funds (MMFs) remain under fire as they try to maintain their role in the liquidity markets. On July 23, 2014, the SEC Commissioners voted 3-2 to adopt new reforms to money market funds. The SEC's rules vary based on the type of fund's investments and the type of shareholder. The rules require more disclosure which will go into effect between nine and 18 months after publication of the rule. The more substantive changes including moving institutional prime funds to a Variable or Floating Net Asset Value (FNAV), gates and liquidity fees will be implemented in two years following final publication of the rule in the Federal Register.

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The impact to investors will be to assume more of the investment risk, receive a potentially lower relative return and run the risk of a suspension of redemptions and/or a redemption fee.

Investor Types

The SEC has established new definitions for money funds based on investor types. Retail funds are those that have policies and procedures in place to reasonably limit investors to "natural persons". Institutional funds have legal entities as shareholders.

New Rules - Summary

- (1) Floating or Variable NAV (FNAV or VNAV)**
Institutional prime and municipal funds will utilize a market-based value rather than amortized cost accounting to determine the daily share prices (Net Asset Value). The variable or floating NAV will be calculated out to the fourth decimal point (e.g., \$1.0000).
- (2) Liquidity Fees and Redemption Gates**
The mutual fund board may impose up to a 2% liquidity fee on redemptions and/or suspend redemptions for up to 10 days if weekly liquidity falls below 30%. If weekly liquidity falls below 10%, the board is required to impose up to a 1% liquidity fee on redemptions unless the board determines that a different fee or no fee is appropriate.
- (3) Enhanced Disclosure and Reporting**
All funds will be required to provide information on their website, provide prompt disclosure of certain events on a new form N-CR, disclose sponsor support, and allow Form N-MFP (portfolio holdings) to be available immediately after filing rather than a 60-day delay.
- (4) Diversification and Stress Testing**
All funds will be required to aggregate affiliates for calculation of the fund's 5% issuer diversification limit, remove the basket allowing a fund to have exposure up to 25% from a single issuer, treat sponsors of asset-backed securities as guarantors subject to the 10% diversification limit applicable to guarantees, and modify stress testing and improve the quality of stress test reporting.

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New Rules - Overview

Fund Type	Prime (Corporate Debt)	Municipal (Tax-Exempt Debt)	Government (Treasury & Agency)
Institutional Funds	Floating NAV Liquidity Fees & Redemption Gates <ul style="list-style-type: none"> • If weekly liquidity <30% at board discretion up to 2% • If <10% required fee up to 1% unless board opts differently Aggregation of affiliates subject to 5% issuer diversification and 10% single institution	Floating NAV Liquidity Fees & Redemption Gates <ul style="list-style-type: none"> • If weekly liquidity <30% at board discretion up to 2% • If <10% required fee up to 1% unless board opts differently Aggregation of affiliates subject to 5% issuer diversification and 15% single institution	Stable NAV No Liquidity Fees or Redemption Gates Ability to incorporate if disclosed in advance Assets (99.5%+) must be invested in cash, govt. securities, and/or repo backed by govt. issues
Retail Funds	Stable NAV Liquidity Fees & Redemption Gates <ul style="list-style-type: none"> • If weekly liquidity <30% at board discretion up to 2% • If <10% required fee up to 1% unless board opts differently Aggregation of affiliates subject to 5% issuer diversification and 10% single institution	Stable NAV Liquidity Fees & Redemption Gates <ul style="list-style-type: none"> • If weekly liquidity <30% at board discretion up to 2% • If <10% required fee up to 1% unless board opts differently Aggregation of affiliates subject to 5% issuer diversification and 15% single institution	Stable NAV No Liquidity Fees or Redemption Gates Ability to incorporate if disclosed in advance Assets (99.5%+) must be invested in cash, govt. securities, and/or repo backed by govt. issues

Daily website disclosures, new material event disclosures (Form N-CR) and disclosure of sponsor support applies to all funds and will become effective 18 months after publication.

Solutions

A separately managed account enables investors to eliminate or mitigate risks while optimizing returns. A separately managed account can be custom tailored to each investor’s sources, uses, and timing of cash flows and risk tolerances. The investor also has greater transparency and the ability to communicate directly with the portfolio manager which provides flexibility to the portfolio in a changing investment environment.