NAVIGATING THE RECENT SEC RULEMAKINGS

Money Market Fund Reforms

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Agenda

- Background
- Overview of Final Amendments
- Key Aspects of Final Amendments
- Board Oversight
- Compliance Dates
- Next Steps
- Questions?

Background

- SEC originally proposed money market fund ("MMF") reforms in December 2021 in response to stresses experienced by institutional MMFs in March 2020
  - Broader stresses in short-term funding markets related to COVID-19 in March 2020 (liquidity related); very different from 2007-2008 financial crisis
  - Recognition that reforms implemented in 2014 had "unintended consequences" in March 2020
  - Proposed reforms primarily focused on perceived structural vulnerabilities of MMFs and methods of allocating liquidity costs to redeeming shareholders in stressed market conditions
- December 2021 proposed reforms included:
  - Removal of existing liquidity fee / redemption gate framework from Rule 2a-7
  - Mandatory swing pricing for institutional prime / tax-exempt MMFs
  - Increase in minimum daily / weekly liquid asset requirements and enhanced reporting requirements
  - Prohibition for stable NAV MMFs to implement certain mechanisms to maintain stable $1.00 share price in negative interest rate environments

Overview of Final Amendments

- In July 2023, SEC approved amendments to Rule 2a-7 and other rules that govern MMFs
  - Approved by vote of 3 to 2, with Commissioners Peirce and Uyeda dissenting
- Among other things, the amendments:
  - Adopted new mandatory liquidity fee framework under Rule 2a-7 for institutional prime / tax-exempt MMFs in lieu of proposed swing pricing framework
  - Removed redemption gate framework from Rule 2a-7, while preserving the discretion to impose liquidity fees for non-government MMFs (decoupled from weekly liquid asset levels)
  - Increased the minimum daily / weekly liquid asset requirements and enhanced reporting requirements
  - Permitted stable NAV MMFs to implement certain mechanisms to maintain stable $1.00 share price in negative interest rate environments
- Amendments represent most significant effort by SEC to reform the MMF industry since the series of reforms adopted following the 2007-2008 financial crisis

Notable Quotables

Is one of [the SEC's] goals to kill prime funds?

SEC Commissioner Hester Peirce (July 2023)

If there is any place where the vulnerabilities of the system to runs and fire sales have been clear-cut, it is money market funds.

Treasury Secretary Janet Yellen (March 2023)

Money market funds … have a potential structural liquidity mismatch. As a result, when markets enter times of stress, some investors—fearing dilution or illiquidity—may try to escape the bear.

SEC Chairman Gary Gensler (July 2023)

The [SEC] should have reproposed [the mandatory liquidity fee mechanism] … the details of which are now being disclosed to the public for the first time. It is not hard to identify potential pitfalls that warrant the benefit of public feedback.

SEC Commissioner Mark Uyeda (July 2023)

Removal of Redemption Gates and Tie Between Weekly Liquid Asset Levels and Liquidity Fees

- The SEC acknowledged that the current liquidity fee / redemption gate framework had unintended consequences and likely contributed to investors' incentive to redeem in March 2020
  - As level of weekly liquid assets approached the 30% threshold at which liquidity fees / redemption gates could be imposed, redemptions generally accelerated in institutional MMFs in March 2020
- Under the amendments, MMFs may no longer impose a temporary redemption gate under Rule 2a-7
  - Investors appeared to be more sensitive to redemption gates in March 2020
  - Continued availability of Rule 22e-3 to stop redemptions in orderly liquidation
- While the amendments retained a ***discretionary*** liquidity fee framework under Rule 2a-7, a MMF's ability to impose a liquidity fee is no longer tied to its weekly liquid assets
  - Discretionary liquidity fees may not exceed 2% of the value of shares redeemed
  - Decision to impose a discretionary liquidity fee may now be delegated to a MMF's adviser or officers
  - Government MMFs may "opt in" to the discretionary fee framework, but are not required to

Mandatory Liquidity Fee Framework

- In lieu of proposed swing pricing framework, SEC adopted a ***mandatory*** liquidity fee framework
  - Applies to institutional prime / tax-exempt MMFs (including internal cash management vehicles)
- When daily net redemptions exceed 5% of a MMF's net assets (or lower threshold determined by Board or its delegate), the MMF ***must*** impose a liquidity fee (unless *de minimis*)
  - Determined based on actual flow information available "within a reasonable period after" the last NAV strike on that day
  - Fee would apply to ***all*** shares redeemed at a price computed on that day (including redemptions requested during earlier pricing periods)
- Mandatory liquidity fee similar in many respects to the "swing factor" under proposed swing pricing framework
  - Fee would equal costs the MMF would incur if it sold a pro rata amount of each security in its portfolio (*i.e.*, a "vertical slice") to satisfy net redemptions
  - Based on good faith estimate, supported by data, of the spread, other transaction and market impact costs
  - For daily and weekly liquid assets, the MMF may assume no market impact costs
  - Exception for *de minimis* costs (less than 1 bp of the value of the shares redeemed); if *de minimis*, the MMF not required to impose a fee
  - If no estimate can be made in good faith, the MMF must impose a default fee of 1% of the value of shares redeemed
- The Board permitted to delegate responsibilities (subject to written guidelines and procedures)

Operation of New Mandatory Liquidity Fee Framework

Generally, funds offering same-day settlement would complete these steps before the 6:45 p.m. ET Fedwire cut-off

Fund strikes its last NAV of day (*e.g.*, 3 p.m.)

The SEC stated in determining when to calculate net flows, fund should consider historical data on when fund typically receives flow information and may also consider period of time needed to calculate and apply fees.

Based on actual flow information available within reasonable period after last NAV strike (*e.g.*, by 5 p.m.), will fund's *net* redemptions be greater than 5% of net assets (or smaller amount determined by board / delegate)?

No

Although mandatory liquidity fee would not be imposed under these circumstances, fund's board or its delegate could impose discretionary liquidity fee (up to 2%) if it determines that fee is in the best interests of the fund

No mandatory liquidity fee is required

SEC expects that funds will typically not impose liquidity fees under normal market conditions under the *de minimis* exception

Yes

If fund receives additional flow information after determining to institute liquidity fee on a given day, fund can take additional flow information into account when determining amount of fee.

Can fund determine, based on good faith estimate supported by data, the costs fund would incur if it sold pro rata amount of each security in portfolio (*i.e.*, a "vertical slice") to satisfy amount of net redemptions?

Yes

Is amount of fee less than 0.01% of the value of shares redeemed (*i.e.*, gross redemptions)?

Yes

No mandatory liquidity fee is required

No

Apply the amount calculated to all shares redeemed at a price computed on that day (even if redeemed during earlier pricing periods)

No

Fund must charge a default 1% liquidity of value of shares redeemed; apply to all shares redeemed at a price computed on that day (even if redeemed during earlier pricing periods)

Mandatory Liquidity Fee Framework – Implementation Challenges and Considerations

- **Multi-NAV Strikes**
  - What happens when an investor redeems prior to a MMF's 9:00 a.m. NAV strike time, before the MMF knows whether it has crossed the 5% threshold for the day?
- **Same-Day Settlement**
  - What happens when there is a "false negative"?
- **Pricing "Grids"**
  - How can MMFs operationalize the calculation of mandatory liquidity fees?
- **Netting**
  - What happens when an investor purchase ***and*** redeems shares on a day a MMF imposes mandatory liquidity fees?
- **Intermediary Arrangements**
  - Do I need to amend a MMF's intermediary agreements?
- **Commercial Implications**
  - How will investors react to mandatory liquidity fees or a potential "hold back" of redemption proceeds?

Board Delegation – Guidelines and Oversight

- The amendments permit the Board to delegate its responsibilities with respect to ***both*** mandatory ***and*** discretionary liquidity fees to a MMF's adviser or officers
  - This is a departure from the proposed reforms as well as the existing redemption gate / liquidity fee framework under Rule 2a-7
- Similar to other delegable responsibilities under Rule 2a-7, the Board must:
  - Adopt and periodically review written guidelines and procedures under which the delegate makes liquidity fee determinations; ***and***
    - Includes guidelines for determining the application and size of liquidity fees
  - Exercise ongoing oversight
    - Includes periodically reviewing the delegate's liquidity fee determinations

Board Delegation – Guidelines and Oversight (con't)

- The SEC stated that the written guidelines should generally address any discretionary aspect of the liquidity fee framework, including:
  - Whether to apply a liquidity fee based on an investor's gross or net redemptions;
  - The approach to measure whether a MMF crossed the 5% net redemption threshold for mandatory liquidity fees;
  - The considerations for determining whether to impose a discretionary liquidity fee; ***and***
  - If a discretionary liquidity fee is imposed, the considerations for determining the size of the liquidity fee

Minimum Daily and Weekly Liquid Assets

- The amendments substantially increase required minimum levels of daily / weekly liquid assets for ***all*** MMFs

10% → 25%

Minimum Daily Liquid Assets

30% → 50%

Minimum Weekly Liquid Assets

- Tax-exempt MMFs continue to be exempt from the minimum daily liquid asset requirement

Minimum Daily and Weekly Liquid Assets (con’t)

- MMFs must also report to the Board if a “liquidity threshold event” occurs (*i.e.*, a MMF’s liquidity drops below ***half*** of the required levels)
  - Initial notification within one business day
  - Within four business days, must also provide brief description of facts leading to liquidity shortfall
- Intended to “better equip [MMFs] to manage significant and rapid investor redemptions in times of stress”
- Because of the changes to the liquidity fee framework and the increase in liquidity minimums, Rule 2a-7 will no longer require MMFs to stress test against ability to maintain 10% of total assets in weekly liquid assets
  - Instead, a MMF will be required to stress test against ability to maintain “sufficient liquidity levels identified in its written procedures”
  - Levels may vary based on type of MMF (retail vs. institutional), the characteristics of the MMF’s investors and the concentration of the MMF’s investor base; other factors may be relevant

Potential Negative Interest Rate Environments

- In negative interest rate environment where a stable NAV MMF has negative gross yield, the MMF may:
  - convert to a floating NAV; ***or***
  - reduce the number of its shares outstanding to maintain a stable $1.00 share price ("RDM")
- Ability for stable NAV MMFs to use RDM represents a change from the proposed reforms
- The Board must determine RDM is in the ***best interests*** of the MMF and its shareholders
  - Considerations include:
    - Service provider and intermediary capabilities
    - State law limitations
    - Tax implications
  - Findings cannot be delegated to the MMF's adviser or officers

Potential Negative Interest Rate Environments (con't)

- Stable NAV MMFs that use RDM must also:
  - Provide timely, concise and plain-English disclosure to investors on RDM
  - Provide advance notification on plan to use RDM and potential effects
  - Include information on RDM and effects in account statements
- Although the amendments did not require stable NAV MMFs to determine that their financial intermediaries are able to process share transactions if they convert to a floating NAV, the SEC provided guidance on how MMFs and financial intermediaries generally should prepare for the possibility of such a conversion or use of RDM
- If circumstances change following the Board's initial best interest determination, the Board should review its determination to ensure that the RDM continues to be in the best interests of the MMF and its shareholders

Enhanced Reporting Requirements

Form N-CR

- MMFs must file report on Form N-CR if they experience a “liquidity threshold event” – that is, if the percentage of total assets in:
  - Daily liquid assets falls below 12.5% ***or***
  - Weekly liquid assets falls below 25%
- MMFs no longer required to file Form N-CR if they impose liquidity fees (mandatory or discretionary)

Form N-MFP

- New items added to Form N-MFP, including:
  - Information regarding “type” of a MMF’s investors that own more than 5% of a share class
  - Composition of a MMF’s investor base by “type” (institutional prime / tax-exempt MMFs only)
  - Information regarding portfolio securities sold for prime MMFs; liquidity fees; and share cancellations
- Increased frequency of reporting certain data points on Form N-MFP

Compliance Dates

On October 2, 2023	•Effective date •Removal of redemption gates •Removal of tie between discretionary liquidity fees and weekly liquid assets •Permission to use RDM in negative interest rate environment
On or before April 2, 2024	•Discretionary liquidity fees and ability by Board to delegate •Increase in daily / weekly liquid assets •Standardization of WAM / WAL calculations •Modified stress testing requirements
On June 11, 2024	•Enhanced reporting requirements on Forms N-MFP, N-CR and PF and related website posting requirements under Rule 2a-7
On or before October 2, 2024	•Mandatory liquidity fee framework for institutional prime / tax-exempt MMFs

What's Next?

There is <u>some</u> flexibility on the timing of completing <u>certain</u> of the items discussed below.

October 2, 2023

- Registration statement disclosure
- Advertisement / website risk legends
- Compliance (Rule 2a-7) procedures

April 2, 2024

- Registration statement disclosure
- Compliance (Rule 2a-7) procedures (including written guidelines if delegation)
- Stress testing procedures
- WAM / WAL specifications and related website posting
- DLA / WLA increase and related website posting

June 11, 2024

- Compliance (Rule 2a-7) procedures
- Enhanced reporting and related website posting

October 2, 2024

- Registration statement disclosure
- Advertisement / website risk legends
- Compliance (Rule 2a-7) procedures (including written guidelines if delegation)
- Pricing grids
- Intermediary agreements

Questions?

(and thank you for attending)

Dechert LLP