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New SEC Money Market Fund Rules:
How Will They Affect Your Investments?

From the Investment Team of PFM Asset Management LLC

On Wednesday, July 23, the Securities and Exchange Commission (SEC) voted 3-2 to adopt new rules that will significantly affect the operations of money market funds that are required to register with the SEC under the Investment Company Act of 1940. It is important for government investors to note that local government investment pools (LGIPs) are not subject to the SEC's money market fund rules because they are exempt from registering under the Investment Company Act of 1940. However, they are regulated by state law.

A summary of the new rules follows:

- Institutional prime and municipal money market funds will be required to adopt a floating net asset value (NAV). Share purchases and redemptions will be based on the current market value of the securities in the funds instead of a $1.00 stable NAV. The result will be small daily fluctuations in the share price for these funds.
- Retail money market funds (defined as a registered fund sold only to natural persons) as well as government money market funds (now defined as funds that invest 99.5% or more of total assets in cash, government securities backed by the full faith and credit of the U.S. government, and/or repurchase agreements that are collateralized solely by government securities or cash) can continue to seek to maintain a stable NAV.
- Money market funds will be able to use liquidity fees and redemption gates, if their board of directors determines it is in the fund's best interest, in order to seek to avoid a "run" on the fund.
  - Liquidity fees could be applied to redemptions if the fund's level of weekly liquid assets falls below certain thresholds.
  - Redemption gates could be imposed to temporarily suspend withdrawals. Redemption gates are limited in duration and also could be applied by the breach of certain liquidity thresholds.
  - Government money market funds are not subject to the new rules concerning liquidity fees and redemption gates, but could voluntarily adopt them if they previously disclose the information to investors.
- Money market funds will be subject to enhanced disclosure requirements in an effort to improve the transparency of fund operations and risks. These include:
  - Disclosure "promptly and publicly" when the fund's weekly assets fall below a 10% threshold.
  - Daily website disclosure of daily and weekly liquidity, net shareholder inflows and outflows, and market-based NAVs per share.
  - Public disclosure of the imposition and/or removal of any liquidity fee or redemption gate.
  - More immediate reporting of fund portfolio holdings, reporting of additional information relevant to assessing money market fund risk, and elimination of the current 60-day delay on public availability of information filed with the SEC.

- More stringent diversification requirements regarding aggregation of affiliated issuers, treatment of guarantors and demand feature providers, and sponsors of asset-backed securities.
- Enhanced requirements for stress testing.
- Removal of references to or reliance on credit ratings, pursuant to the terms of the Dodd-Frank Act of 2010.
- The changes will not go into effect immediately; money market funds will have up to two years to comply with various aspects of the new rules.

The new SEC rules are the latest move by the SEC to respond to the financial crisis of 2008. Investors in prime institutional money market funds—which will switch to a floating NAV and where boards now have the authority to implement penalties and gates for investor redemptions—will feel the most significant impact. The Government Finance Officers Association (GFOA) and the National Association of State Treasurers, among other organizations, objected to the proposals to float NAVs and impose fees and gates. The GFOA characterized Wednesday's action as "the latest in a series of actions and proposals by the SEC that harm state and local governments either deliberately or through indifference."

In related action, the U.S. Treasury and the Internal Revenue Service are expected to issue new rules to address tax accounting problems that the floating NAV will create for taxable entities. The Governmental Accounting Standards Board (GASB) may provide further or revised guidance on its treatment of cash equivalents in light of the rule change. This could affect how investors in LGIPs account for these investments.

As a manager of both LGIPs and an institutional money market fund, PFM Asset Management LLC will continue to follow these developments and provide more information as necessary.