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Money Market Funds: Regulatory Reform Webinar

Moderator: **Jon-Luc Dupuy**, Partner, K&L Gates

Panelists: **Peter Crane**, President & Publisher, Crane Data

Debbie Cunningham, Executive Vice President, CIO - Global Liquidity Markets, Senior PM, Federated Hermes

Madison Dischinger, Corporate Counsel, Federated Hermes

PANELISTS

***Peter Crane**, President & Publisher, Crane Data*
Pete is president of Crane Data, a money market and mutual fund information firm. Crane Data is the publisher of Money Fund Intelligence, a monthly report that includes new, analysis, performance statistics and indexes on money market mutual funds and the cash investment industry.

***Debbie Cunningham**, Executive Vice President, CIO - Global Liquidity Markets, Senior PM, Federated Hermes*
Debbie is Chief Investment Officer of Global Liquidity Markets at Federated Hermes, Inc. She joined Federated Hermes in 1981 and has 35 years of investment experience. Since 1990, she has been a portfolio manager for all government and prime liquidity products at Federated Hermes.

***Madison Dischinger**, Corporate Counsel, Federated Hermes*
Madison is Corporate Counsel at Federated Hermes. She joined Federated Hermes in 2012 and was appointed Corporate Counsel in 2015. As corporate counsel, Madison plays a strategic role in the company's legal and regulatory initiatives and provides distribution oversight and support related to the sales, services and operations of Federated Hermes funds.

MONEY MARKET RULE AT A GLANCE

- Third revision of Rule 2a-7 in 15 years
- Swing pricing not adopted as proposed
- Instead the SEC adopted a new liquidity fee regime which includes both discretionary and mandatory liquidity fees
- Weekly Liquid Assets no longer a trigger for the imposition of liquidity fees
- Redemption gates will no longer be permitted under the new rules
- Weekly and Daily Liquid Assets requirements have been increased
- Funds may convert to FNAV or impose an RDM during a negative interest rate event

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MANDATORY LIQUIDITY FEES

- Redemption Gates and Liquidity Fees tied to weekly liquid assets had unintended consequences
- Instead, institutional prime and tax-exempt money market funds only must impose a mandatory liquidity fee if:
  - It has net redemptions in **excess of 5% of net assets** on a given day; and
  - Its transaction costs (including market impact costs) of liquidating a corresponding vertical slice of the portfolio are more than ***de minimis*** (one basis point of the value of the shares redeemed)
  - If the fund cannot determine that amount based on current market conditions, a set **default fee of 1%** will apply
  - Calculation of the liquidity fee amount will require **gross transaction activity** from intermediaries to ensure that the liquidity fee is calculated and allocated among all redeeming shareholders.

DISCRETIONARY LIQUIDITY FEES

- ***Irrespective of*** the fund's portfolio liquidity or redemption levels, all nongovernment MMFs may impose a discretionary liquidity fee if the fund's board determines that such fee is in the best interests of the fund
- "Best interest" determination may be delegated and implemented based on predetermined factors or triggers.

PORTFOLIO LIQUIDITY REQUIREMENTS

- Daily liquid asset levels have increased from 10% to 25%
- Weekly liquid asset levels have increased from 30% to 50%
- If these levels drop to less than 12.5% or 25%, respectively (a "threshold liquidity event"), funds must notify the Board and file Form N-CRs.

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OPTIONS FOR NEGATIVE INTEREST RATE ENVIRONMENTS

- If a negative interest rate results in a gross negative yield, a stable NAV MMF Board may determine to:
  - convert the fund to a floating NAV; or
  - implement a reverse distribution mechanism (by reducing outstanding shares) to maintain a stable NAV if the board determines that it is in the best interests of the fund and its shareholders
- The SEC had previously sought to prohibit such RDM/share cancelation transactions
- To implement an RDM, stable NAV funds will also need to include appropriate disclosure about its share cancellation practices

Please submit all questions via the “Chat” feature on Webex

OTHER REQUIREMENTS

- Standardization of weighted average maturity and weighted average life calculations
- Changes to the requirements relating to stress testing thresholds
- Revisions to Form N-CR and N-MFP to reflect changes to the reporting requirements of liquidity thresholds (N-CR) and liquidity fees (N-MFP)
- Changes to Form PF for private money market funds
- Corresponding changes to Form N-1A disclosures

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COMPLIANCE DATES

Date	Reform
October 2, 2023	• Remove the ability to use redemption gates • Remove the link between weekly liquid assets and liquidity fees • Permit the use of reverse distribution mechanisms and the conversion to floating net asset value during negative interest rate environments
April 2, 2024	• Discretionary fees • New weekly and daily liquid asset requirements go into effect
June 11, 2024	• Updates to Forms N-CR, N-MFP, and PF
October 2, 2024	• Mandatory fees

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PANEL DISCUSSION

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MONEY MARKET FUND ASSET FLOWS

- Latest reforms intended to address events that occurred in March 2020
  - Assets transitioned from prime MMFs to government MMFs
  - Some funds were managed to maintain weekly liquid assets and not trigger fees or gates
  - Possible shareholder dilution
  - No fee or gate was imposed despite potential and ability to do so
  - Stress on commercial paper market
- Current Asset Levels
- Market Concentration
- Trends

LIQUIDITY FEES

- Liquidity Fees versus Swing Pricing
  - Are Liquidity Fees just another form of Swing Pricing?
- Calculating Liquidity Fees
  - Based on 5% **net** redemption trigger
    - Trigger must be determined within "reasonable period" of time after the Fund's last NAV calculation
    - Based on **actual** not estimated flow information
      - May not be able to include all fund flows for that day (e.g., T+1 trades)
      - Possibility of false positives or false negatives
  - Estimates relate to the calculation of transaction and market impact costs
    - If the fund cannot determine that amount based on current market conditions, a set default fee of 1% of the value of shares redeemed will apply
  - Need gross transaction activity from intermediaries to ensure that the liquidity fee is calculated and allocated equitably among all redeeming shareholders
    - Transaction and market impact costs are divided by the gross shares redeemed
    - Intermediary arrangements
    - Funds can (but are not required to) net individual shareholder transaction activity

LIQUIDITY FEES (CONTINUED)

- Market impact costs
  - By security or security type?
  - DLA and WLA may have a market impact cost of zero
  - Reconciling the imposition of a liquidity fee if redemptions did not result in corresponding transaction or market impact costs
  - Possibility of lower triggers for mandatory fees?
- Discretionary fees
  - Factors, considerations, and triggers
  - Delegation of “best interest” determination
  - How discretionary and mandatory fees could work in tandem
    - “In addition, to the extent that a fund did not have net redemptions of more than 5% within a reasonable period after the last pricing period but subsequently received additional net redemptions that would cause it to cross the threshold, the fund should consider imposing a liquidity fee under the discretionary fee provision...”

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POTENTIAL IMPLICATIONS OF THE NEW REGIME

- Impact on institutional MMFs
  - Impact on multi-strike MMFs
  - Impact on same-day settlement
  - Asset flows

- What’s Next?
  - Swing Pricing or liquidity fees for non-MMF mutual funds
  - Impact on private money market funds
  - Reform 4.0 – what is the next wave of Rule 2a-7 reforms?

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QUESTIONS

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