PERKINS COIE
TRUST COMPANY

What Investors Should Know About Money Market Reforms

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A description of money market reforms that will impact investors.

On September 16, 2008, during the global financial crisis, the Reserve Primary Fund—a money market fund with approximately $62 billion in assets—lowered its share price below $1, primarily due to its exposure to Lehman Brothers debt. Between September 2, 2008 and October 7, 2008, a period that included the Lehman Brothers bankruptcy and the AIG bailout, investors withdrew $498 billion in assets from prime money market funds like the Reserve Primary Fund and fled to the safety of government money market funds. This event triggered a review by the Securities and Exchange Commission (SEC), which then issued rules that included tighter restrictions on portfolio holdings, enhanced liquidity and credit quality requirements, and greater transparency. In 2014, the SEC formally approved additional reforms for money market funds to avoid "the runs that can have destabilizing implications for financial market and the economy." This white paper outlines these reforms, which take effect in October 2016, and the potential impacts to investors.

Impact on Institutional Investors

The term "institutional investor" applies to nonprofit accounts, such as foundations and endowments, defined benefit plans, irrevocable personal trusts with a bank as sole trustee, custody accounts for corporations, municipalities, and insurance companies, and other entities that are not beneficially owned by natural persons. Institutional accounts will have access to Treasury money market funds, government money market funds, or floating rate net asset value (FNAV) prime money market or municipal money market funds. FNAV funds must float their NAVs per share to the nearest 1/100th of a cent (e.g., $1.0000). Floating rate funds will negate one of the key appeals of money market funds to investors, namely, stable valuation. The idea is to have investors recognize the true amount of risk they are exposed to in these vehicles. Another key change for institutional investors is the addition of redemption fees and gates. Depending on the amount of true daily liquidity available in the fund, the fund's board may elect to impose redemption fees and gates to prevent disorderly runs on the fund. The gates can last as long as 10 days, and exit fees can be as high as 2%.

Some institutional accounts will initially prefer government funds with a stable asset value, but may eventually embrace floating rate prime funds with higher yields. Historically, prime funds have offered attractive yield spreads over government funds. Corporate treasurers, on the other hand, may bring the cash management function in-house. Managers with sufficient expertise may prefer to control their liquidity and avoid unexpected fees. In the near term, expect to see a surge in demand for treasury and agency securities; however, over the longer term, demand will shift to corporate commercial paper and other slightly riskier short-term products.

Impact on Retail Investors

Retail money market funds will be defined as funds limiting beneficial owners to natural persons. This includes interests held through certain personal trusts, investment agency accounts, retail brokerage accounts, IRAs, SEP, Simple and KEOGH plans, 401(k) and other participant-directed defined contribution pension and employee benefit plans, and any funds held through omnibus accounts at custodians for the benefit of natural persons. The good news for retail investors is that they will continue to have access to stable NAV money market funds—government or prime. However, the liquidity fees and redemption gates that apply to institutional funds will apply to retail funds as well. Funds

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will be *allowed* to impose a liquidity fee of up to 2% if the fund's level of weekly liquid assets were to fall below 30% of total assets. Also, funds will be *required* to impose a 1% liquidity fee if the fund's level of weekly liquid assets were to fall below 10% of total assets. The fund's board of directors may impose a higher or lower fee than 1%, or may elect not to take any action. A final consideration is that a fund's board of directors will be permitted to temporarily (for up to 10 business days) suspend redemptions if a fund's level of weekly liquid assets were to fall below 30% of total assets.

The SEC is primarily concerned with the highly volatile behavior exhibited by institutional investors in times of crisis. Retail investor activity during the financial crisis was more balanced, with purchases and redemptions largely offsetting each other. Retail investors, whether making their own investment decisions or using an outside advisor, generally look at cash invested in money market funds as their safe harbor. During a financial crisis, retail investors will be more likely to increase cash reserves than to move to other, riskier asset classes.

The investment team at Perkins Coie Trust Company has spoken with a number of major money market fund managers, including our primary provider, Goldman Sachs. Companies are already conducting stress tests and feel that they will have no trouble providing necessary liquidity and complying with the new reforms before the October 2016 deadline. We expect minimal impact from these changes and will stay informed as these reforms are put in place.

SEC Regulations for Money Market Mutual Funds

Major changes noted in blue.

Retail Funds

Ownership is restricted to individual investors (defined as "natural persons").

	Net Asset Value	Redemption Fee	Redemption Suspension
Prime Municipal/Tax-Exempt	Stable at $1.00	Up to 2%	Up to 10 business days

Institutional Funds

Ownership is open to all investors, including individual investors.

	Net Asset Value	Redemption Fee	Redemption Suspension
Prime Municipal/Tax-Exempt	Floating	Up to 2%	Up to 10 business days

Retail and Institutional Funds

	Net Asset Value	Redemption Fee	Redemption Suspension
Government	Stable at $1.00	None*	None*

*Government money market funds are permitted, but not required, to impose redemption fees and restrictions.

Sources: Vanguard, Federated, PIMCO, UBS, Goldman Sachs