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August 22, 2016

Money Market Reform

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"To protect smaller investors in money market funds, the SEC has already implemented some changes to regulations regarding liquidity, credit quality, and transparency."

The Securities and Exchange Commission (SEC) has introduced a number of regulatory changes to money market mutual funds. This is in response to a large money market fund that "broke the buck" during the 2008-09 credit crisis (meaning that it fell below the $1 net-asset-value level) because of exposure to Lehman Brothers debt securities, which caused a run on assets. Normally, money market funds maintain a net asset value of $1. Large institutions were the first to redeem funds, which left mom-and-pop investors as the holders of last resort, subjecting them to losses in cash positions otherwise assumed stable.

To protect smaller investors in money market funds, the SEC has already implemented some changes to regulations regarding liquidity, credit quality, and transparency. However, these changes failed to address the structural risks that were exposed during the peak of the financial crisis.

The final round of changes, which will go into effect October 14, are designed to enhance the stability of money market funds and will differentiate money market funds as either institutional or retail.

Prime and municipal tax-exempt *institutional* funds will be open to all investors, whether they are "natural persons" or "institutions." However, these funds will move from a stable Net Asset Value (NAV) to a floating NAV based on performance of the underlying securities. Prime and municipal tax-exempt *retail* funds will be open only to individuals with a social security number, considered "natural persons" by the SEC, and will maintain a stable NAV, just as they operate today.

The SEC initiated this rule change because institutional investors are more likely to redeem funds during times of market stress. By segregating the "institutional" and "retail" investors, smaller mom and pop investors utilizing "retail" funds will not be affected by the actions of these larger investors and their funds will maintain a stable NAV.

New regulations also include an option for all prime and municipal tax-exempt money-market funds to disallow redemptions for up to 10 days (gates) and to impose a redemption fee of up to 2% (fees). The actual implementation of these gates and fees is considered unlikely, as most money market funds will be reluctant to adopt such polices unless difficult market conditions force them to.

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How This Affects Your Investments

Most of our accounts will not be materially affected; the beneficial owner of an agency account, IRA account, revocable trust account, or 401(k) account is a "natural person" and will be considered a retail investor. These accounts will be invested in "retail" money market funds that maintain a stable NAV.

Endowments, foundations, irrevocable trusts, and corporate accounts will be considered institutional. For institutional accounts, we do not think it is prudent to subject money market balances to a floating NAV, since this puts cash positions at risk of losses. The only stable-NAV money market option for institutional clients is a government money market fund. Government money market funds will maintain a stable NAV for both retail and institutional clients, but will continue to offer a very low yield.

The option we will be offering for institutional accounts is an insured deposit sweep program. This works the same way as a money market fund, except that the cash balances are swept daily to a number of FDIC-insured banks. The banks pay a fee for these sources of deposits, which are then passed on to the client. The yield is well over that of government money market funds, while maintaining a stable NAV. Because cash balances are swept to a total of 10 banks, each of which provides up to $250,000 in FDIC insurance, this program is able to provide up to $2.5 million per client, per account type of FDIC insurance. In a nutshell, we like this program for our institutional investors because they get a higher yield in an FDIC-insured investment vehicle that is not subject to a floating NAV.

This is an important change to money-market mutual funds. It will impact an array of our clients, which is why we want to communicate it to you.

As always, we are available and happy to address any questions or concerns you may have now and going forward.

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