



# Money Market Mutual Funds: Change is Coming

SEC to Change the Way Money Market Funds Work

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# Agenda

- Status of the Money Market Industry
- New Securities and Exchange Regulations
- Understanding the Role of Cash Equivalents
- Next Steps

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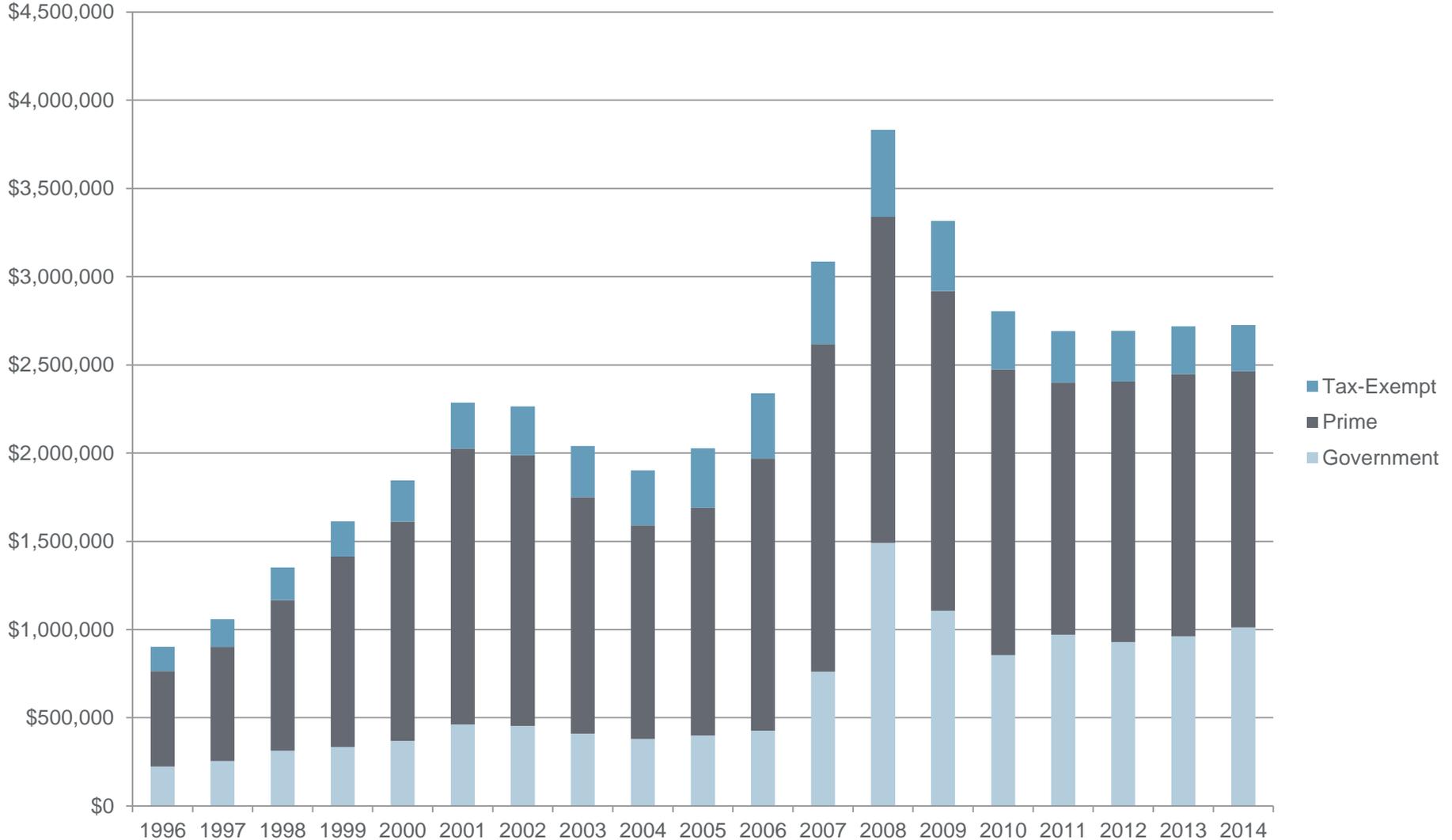
Prior to founding the Multnomah Group in 2003, Erik served as a Vice President of Retirement Services and led the Portland, OR practice of a national retirement services firm. In that position Erik was a founding member of the firm's national Investment Committee and had oversight for business development in the western United States.

Erik is a member of the CFA Institute, the CFA Society of Portland, the CFA Society of Seattle, the American Society of Pension Professionals and Actuaries, the Portland Chapter of the Western Pension & Benefits Council, and the Society for Human Resource Management. Erik holds a B.B.A. from the University of Iowa.

# Fixing the Gate Once the Horse Has Left the Barn

- September 29, 2008 the US Treasury Department established a Temporary Guarantee program for Money Market funds
- US Treasury assessed a fee of 0.01% on impacted funds
- September 18, 2009 Guarantee program expires
- US Treasury had no claims and earned approximately \$1.2 B in participation fees
- June 5, 2013 SEC proposes Rule 2A-7 designed to limit money market investments in
  - the securities of any one issuer of a first tier security to no more than 5% of fund assets
  - the securities subject to a demand feature or a guarantee to no more than 10% of fund assets from any one provider
- On July 23, 2014 the SEC adopted final amendments to Rule 2A-7
- October 14, 2016 is the final effective date for changes in product structure

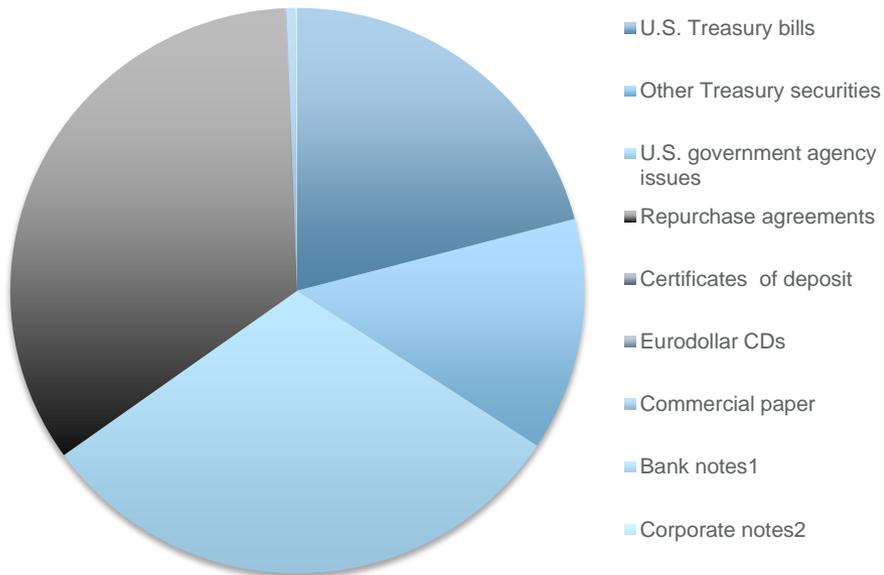
# Size of the Money Market Industry Remains Strong



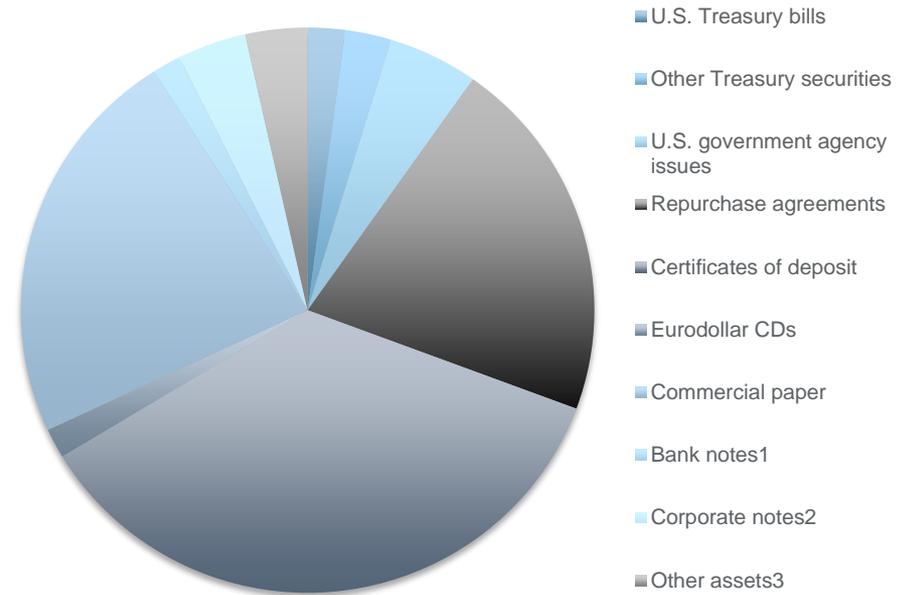
\*Data from [Investment Company Institute](#)

# Governmental Funds vs. Prime Funds

## Governmental Money Funds



## Prime Money Funds



\*Data from [Investment Company Institute](#)

# Final SEC Rules

Reform	Final SEC Rule	Implementation Date
Floating NAV	<ul style="list-style-type: none"> <li>Applicable funds will price and transact at a net asset value per share that can change, or “float” based on pricing the underlying fund holdings out to four decimal places</li> </ul>	October 14, 2016
Liquidity Fee	<ul style="list-style-type: none"> <li>If a fund’s weekly liquid assets were to fall below 30%, fund’s board may impose a 2% fee on redemptions</li> <li>If a fund’s weekly liquid assets were to fall below 10%, redemptions will be subject to a 1% fee, unless fund’s board determines otherwise</li> </ul>	October 14, 2016
Redemption Gate	<ul style="list-style-type: none"> <li>If a fund’s weekly liquid assets were to fall below 30%, fund’s board may suspend redemptions for up to 10 days</li> </ul>	October 14, 2016
Retail Fund Definition	<ul style="list-style-type: none"> <li>Retail fund limit shareholders to beneficial ownership by “natural persons” (individuals)</li> <li>Institutional funds are open to any shareholders, including individuals, small businesses, and large corporations</li> </ul>	October 14, 2016

\*Data from [Fidelity Investments](#)

# Structural Changes to MMFs in Final SEC Rules

Fund Type	NAV	Liquidity Fee	Redemption Gate
US Treasury	Stable	No	No
Government	Stable	No	No
Retail Municipal/Tax-Exempt	Stable	Yes	Yes
Retail Prime/General Purpose	Stable	Yes	Yes
Institutional Municipal/Tax-Exempt	Floating	Yes	Yes
Institutional Prime/General Purpose	Floating	Yes	Yes

\*Data from [Fidelity Investments](#)

# Examples of Types of Retail and Institutional Accounts

Examples of Types of Retail Accounts	Examples of Types of Institutional Accounts
Natural persons represent the beneficial ownership interest of these accounts	Natural persons do not represent the beneficial ownership of the accounts
<ul style="list-style-type: none"><li>• Individual accounts (brokerage or mutual fund)</li><li>• Retirement accounts, including workplace defined contribution plans</li><li>• College savings plans</li><li>• Health savings plans</li><li>• Ordinary trusts</li><li>• Accounts sold through intermediaries with the underlying beneficial ownership being a natural person</li></ul>	<ul style="list-style-type: none"><li>• Accounts with registrations based on tax identification number with the beneficiary not being a natural person</li><li>• Small business accounts</li><li>• Defined benefit plans</li><li>• Endowments</li></ul>

\*Data from [Fidelity Investments](#)

# Types of Fund Holdings that Satisfy SEC Definitions of Daily and Weekly Liquid Assets

Daily Liquid Assets	Weekly Liquid Assets
<ul style="list-style-type: none"><li>• Cash</li><li>• Direct obligations of the US government</li><li>• Securities that will mature or are subject to a demand feature that is exercisable and payable with one business day</li><li>• Receivables scheduled to be paid within one business day</li></ul>	<ul style="list-style-type: none"><li>• Daily Liquid Assets</li><li>• Government agency discount notes with remaining maturities of 60 days or less</li><li>• Securities that will mature or are subject to a demand feature that is exercisable and payable within five business days</li><li>• Receivables scheduled to be paid within five business days</li></ul>

\*Data from [Fidelity Investments](#)

# Impact of the Change to Money Market Rules

- Plan sponsors are likely to move to government and treasury funds to avoid redemption gates, liquidity fees, and floating NAV
- Move to higher quality government debt and shorter duration positions will likely reduce expected returns
- Plan sponsors will need to evaluate the role of cash equivalents in a defined contribution plan

# Cash Equivalents in the New Environment

## Stability of Value

- Long-term vs. Daily
- Significant impact when markets are their most volatile

## Liquidity

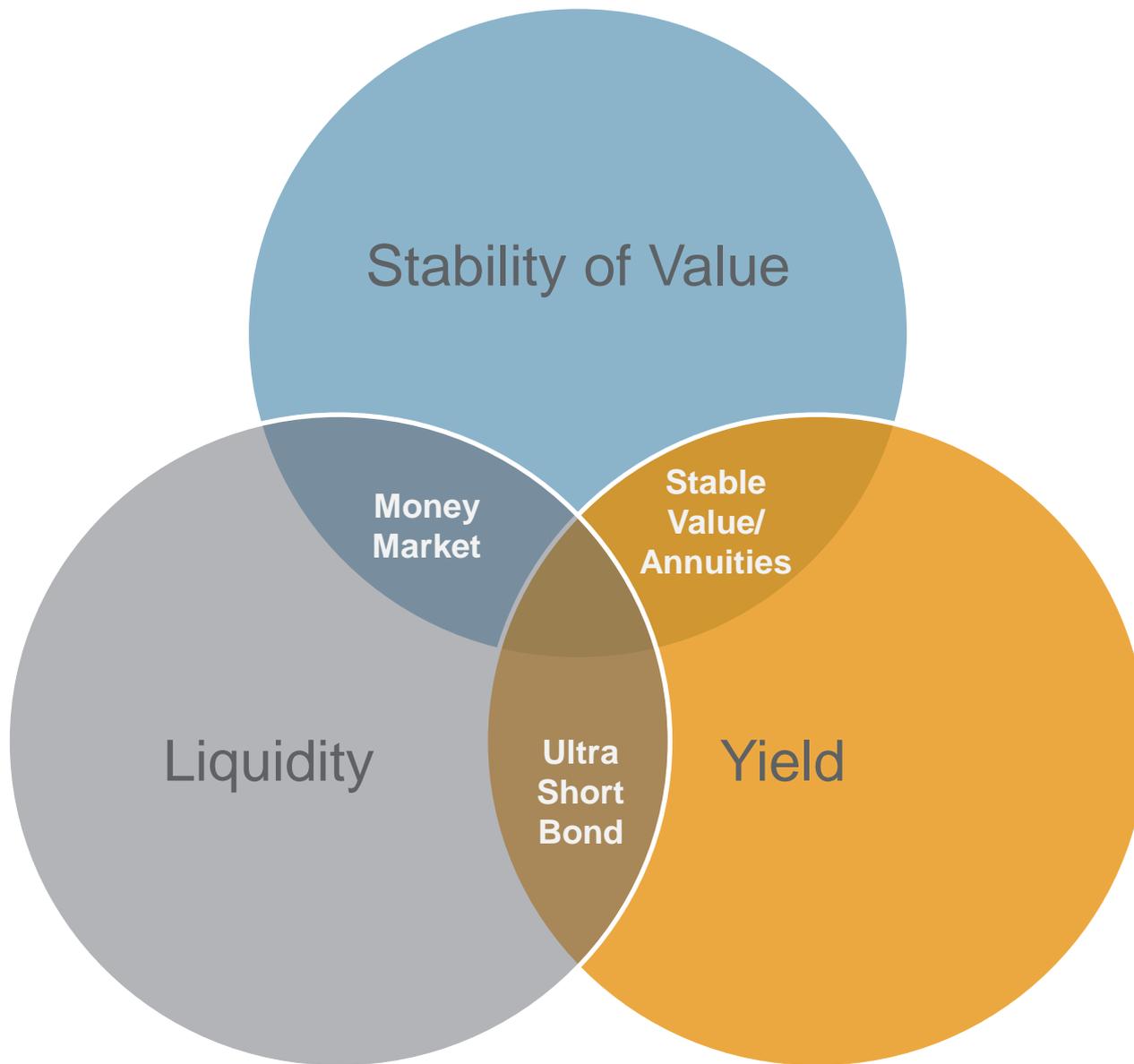
- Participant vs. Plan level
- Impacts recordkeeping and pricing

## Yield

- Short-term yield responsiveness vs. Long-term yield and performance
- Determinants of short-term yield

## Sophie's Choice for Plan Sponsors

You can have any two of the above, but likely not all three



# Stable Value Structures

- Objective: Capital preservation coupled with steady, positive returns
- Expected to provide a return premium to money market funds because of the ability to accept greater interest rate and credit risk
- Synthetic GIC stable value funds consist of short / intermediate duration, high credit quality bond portfolio
- Bond portfolio is “wrapped” with contracts from wrap issuers (banks or insurance companies) that enable participants to transact at book value
- Wrap contracts do not protect against credit losses
- Investment returns and gains / losses are smoothed using a formula to maintain stable book value
- Structured as a separate or pooled account (collective investment trust)
- Separate accounts are for large plan sponsors (single plan)
- Pooled accounts consist of many (sometimes thousands) of smaller plan sponsors

# Ultra Short Term Bond

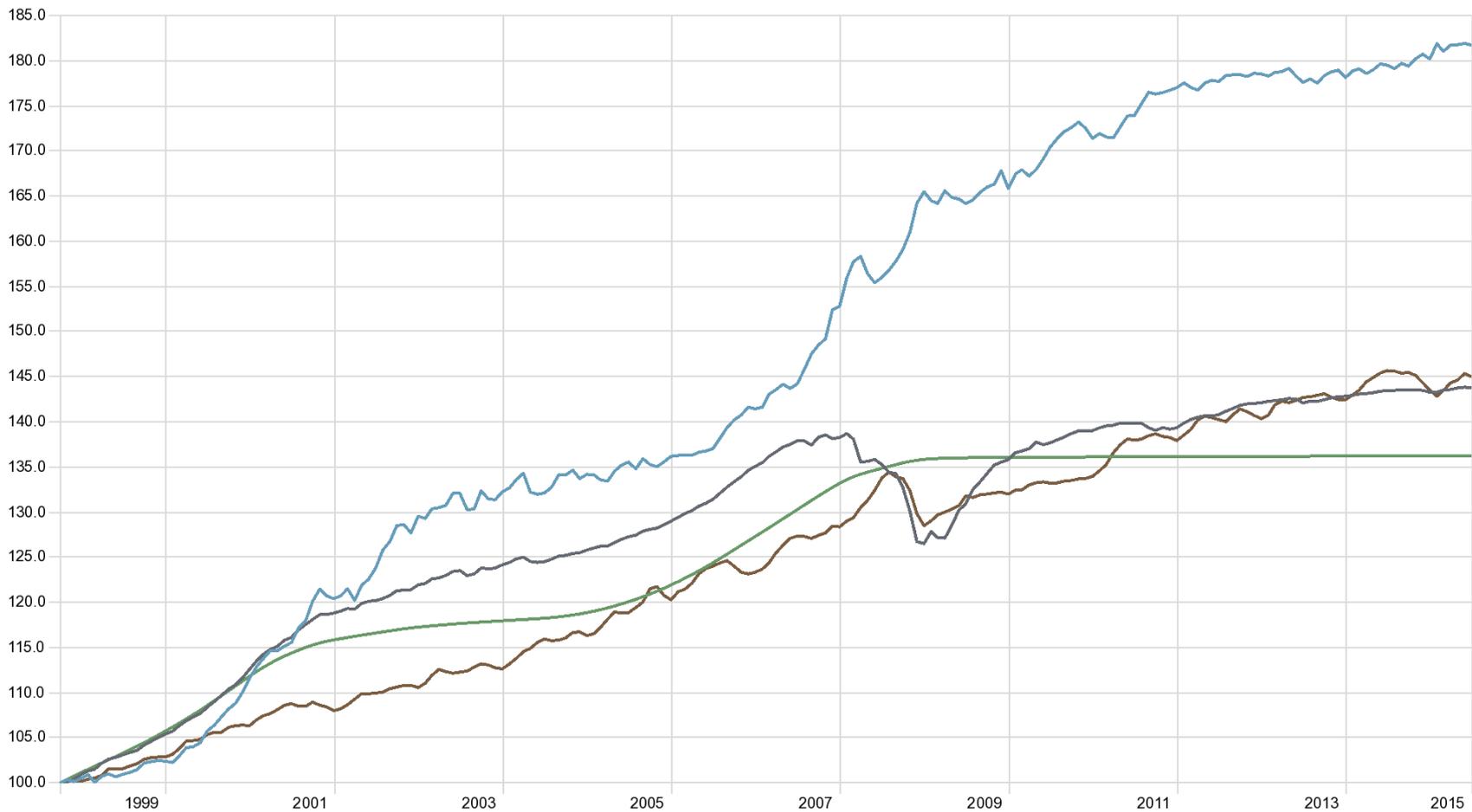
“Ultrashort-bond portfolios invest primarily in investment-grade U.S. fixed-income issues and have durations typically of less than one year. This category can include corporate or government ultrashort bond portfolios, but it excludes international, convertible, multisector, and high-yield bond portfolios. Because of their focus on bonds with very short durations, these portfolios offer minimum interest-rate sensitivity and therefore low risk and total return potential.”

– Morningstar

- Category Average Statistics (Morningstar)
  - Average Effective Duration – 0.41
  - Average Effective Maturity – 0.94
  - Average Credit Quality - A

# Growth of \$100

Time Period: 10/1/1998 to 6/30/2015



— Barclays Stable Value Benchmark TR USD      181.7     
 — US OE Ultrashort Bond      136.2     
 — US Money Market - Taxable      143.8  
— IA SBB I US Inflation      145.0



# Considerations in Communicating Costs and Benefits to Participants

	Portfolio	Advantages	Disadvantages
Money Market	Ultra-short bonds, treasuries, and commercial paper. Money market holdings in mutual funds are subject to strict federal guidelines	<ul style="list-style-type: none"> <li>• Generally, the most secure and liquid place to store assets</li> <li>• Short-term portfolio responds rapidly to changes in the interest rate</li> </ul>	<ul style="list-style-type: none"> <li>• Participant misuse</li> <li>• Low returns, potentially less than inflation</li> </ul>
<i>US TREAS T-Bill Auction Ave 3 Mon 5-Year Return 0.06%<sup>1</sup></i>			
Fixed Annuity/GICS	Promise to pay from the issuing insurer backed by assets in the insurer's general account. Quality and security dictated by the state in which the insurer does business	<ul style="list-style-type: none"> <li>• Should provide a higher crediting rate than money markets over full market cycles</li> <li>• Position is backed by the full faith and credit of the issuer</li> <li>• Future returns are generally announced in advance</li> </ul>	<ul style="list-style-type: none"> <li>• Participant misuse</li> <li>• Liquidity constraints</li> <li>• Difficult to analyze</li> <li>• Cost structure is generally not determinable</li> </ul>
<i>Typical Fixed Annuity Return 1.5% – 3.5%<sup>1</sup></i>			
Ultra Short Bond	Short-term high-quality bonds, including asset-backed, government, and investment-grade corporate securities. The majority of securities in the fund will have an expected maturity of 0–3 years, and will generally be held until maturity.	<ul style="list-style-type: none"> <li>• Should provide a higher crediting rate than money markets over full market cycles</li> <li>• Short-term portfolio responds rapidly to changes in the interest rate</li> </ul>	<ul style="list-style-type: none"> <li>• Floating NAV makes the portfolio appear more “risky” than alternative asset structures</li> </ul>
<i>Barclays US Treas Bellwether 1 Year Index 5-Year Return 0.37%<sup>1</sup></i>			

<sup>1</sup>Returns as of June 30, 2015

# Next Steps

1. Review the portfolio construction strategy
2. Adjust your Investment Policy Statement
3. Select your portfolio matrix
4. Communicate the product to participants
5. Reassess

# Disclosures

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