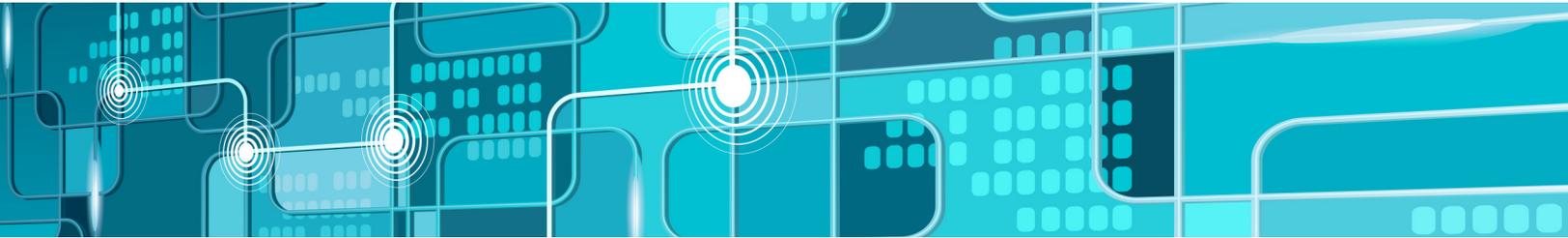


Money Market Fund Reform: Final Rule Implementation

Operational Readiness for Four-Decimal Floating Net Asset Value (NAV) Money Market Funds



Introduction

In July 2014, the Securities and Exchange Commission (SEC) adopted amendments to rules that govern money market funds. According to the SEC, the rules are designed to address money market funds' susceptibility to heavy redemptions in times of stress, improve their ability to manage and mitigate potential contagion from such redemptions, and increase the transparency of their risks, while preserving, as much as possible, their benefits. One of these reforms requires certain money market funds to use a four-decimal floating net asset value (NAV).

Funds and intermediaries that choose to support these products have a number of operational considerations that relate to the use of a four-decimal floating NAV.¹ Various stakeholders, especially shareholders and the fund and intermediary employees who service shareholders, need to become familiar with the practical implications of money market fund reform final rules² and how they may affect the servicing of shareholder accounts.

To assist funds and intermediaries with identifying operational considerations regarding the implementation and support for a four-decimal floating NAV money market fund, a subgroup of the ICI Money Market Fund Reform Working Group on Four-Decimal NAV Calculation was organized to contribute to this document. Specifically, the group focused on helping constituencies understand the impact of the floating NAV on operations, fund and intermediary staff, and—most importantly—shareholders.

A New Paradigm for Shareholders

Shareholders in floating NAV money market funds will need to become accustomed to account balances and transactions calculated by an NAV with four decimal places (1/100th of a cent). The traditional \$1.00 stable NAV that has contributed to the ease of use and understanding of money market funds can no longer be assumed in a floating NAV environment. Likewise, transaction shares and account balances will now carry out up to three decimal places (1/1000th of a share), versus the two decimal places (1/100th of a share) used today. Investors using funds that transition to a floating NAV will require education prior to the fund's first floating NAV calculation to understand how account balances, transaction shares, and redemption proceeds may be affected.

¹ A discussion of fund and intermediary technical readiness for four-decimal floating NAV money market funds was developed by a subgroup of the ICI Money Market Fund Reform Working Group on Four-Decimal NAV Calculation and can be found at www.ici.org/pdf/15_ops_mmf_technology.pdf.

² See ICI Memorandum 28281.

- » Post-reform, any NAV change from a \$1.0000 NAV will cause account values to fluctuate, even if account share balances do not change. Account value will behave similarly to other variable NAV funds and cannot be assumed to be constant from one pricing event to the next.
- » Shareholders placing orders in shares today may not understand the potential differences between share quantity and purchase or redemption dollar amount when the NAV is not \$1.0000. Funds and intermediaries should consider the impact of the floating NAV on share purchase and redemption orders to ensure sufficient communication and required disclosure has occurred with stakeholders. The consequences include:
 - When the NAV floats, the dollar amount paid by the shareholder to settle a share-based purchase will vary from the number of shares acquired.
 - When the NAV floats, the dollar amount received by the shareholder from the fund to settle a share-based redemption will vary from the number of shares redeemed.
 - Because the dollar amount of share-based trades is unknown until the next available NAV is calculated, shareholders will need a notification (i.e., trade confirmation) of dollars they should remit or will receive for share-based purchases and redemptions, respectively.
 - The use of a four-decimal NAV to calculate redemption proceeds that are subsequently rounded to two decimal places for payment creates the potential for a one-cent discrepancy between the dollar amount requested by the shareholder and the actual mathematical calculation of the payment by trading systems.³ This difference can create customer service and account reconciliation challenges, as well as shareholder confusion.
- » Like other floating NAV funds, fractional shares associated with transactions and account balances will extend to three decimal places instead of the current two decimal places. The three-decimal place field could reflect a value that has been rounded or otherwise adjusted; such rounding or adjustment does not occur in today's constant \$1.00 NAV money market funds.

Shareholders initiate and receive information about their money market fund accounts in a variety of ways. To ensure the impact of a floating NAV is sufficiently explained through enhanced disclosure or educational materials funds and intermediaries should consider evaluating the following:

- » statements and confirmations;
- » shareholder account inquiry and transaction processing through the web or voice-response unit (VRU);
- » tax reporting of gain/loss information under allowable accounting methods;⁴
- » general educational materials on money market funds—in print or through the web;⁵ and
- » other shareholder interfaces or intersections.

³ A spreadsheet illustrating the potential impact of the mathematical calculation on resulting dollar and share balances (e.g., use of rounding or truncation) was developed by a subgroup of the ICI Money Market Fund Reform Working Group on Four-Decimal NAV Calculation and can be found at www.ici.org/pdf/15_ops_nav_consider_instruct.pdf.

⁴ Final money market fund reforms prescribe use of the NAV method of accounting for floating NAV money market funds, which permits funds and intermediaries to provide information so shareholders can aggregate annual gain/loss reporting for an account. Funds and intermediaries may also voluntarily elect to provide tax-related information to investors under an alternative accounting method. See Internal Revenue Bulletin: 2014-33 at www.irs.gov/irb/2014-33_IRB/ar13.html for details.

⁵ Final reforms require all money market funds to disclose six months of daily “shadow” NAVs, calculated to four decimal places, on fund websites by April 14, 2016. To disclose six months of daily shadow NAVs beginning April 14, 2016, funds should calculate and save daily shadow NAVs to four decimal places beginning October 14, 2015.

The Critical Role of Fund and Intermediary Employees

Like shareholders, fund and intermediary employees who support floating, four-decimal NAV money market funds must become accustomed to the new operating model. Many organizations participating in ICI working groups have discussed developing electronic and print resources that educate staff on the operational effects of money market fund reform, including four-decimal NAV. Organizations may consider the following:

- » Staff training: In the months preceding the final implementation of reforms, funds and intermediaries should consider staff training that may include a general overview of money market reforms, the related impact to product lineups, and how those product lineups will be supported by the fund or intermediary.
- » Correction and adjustment processing: Associates involved with floating NAV money market fund trade corrections and adjustments need to understand the potential gain/loss impact of such transactions.
- » Procedural changes: Related changes to internal procedures and communications regarding the processing of trade corrections and adjustments may be required.
- » Call center: Associates may require updated scripting for verbal confirmations of floating NAV money market fund trades to stress the variable nature of the NAV. Likewise, some shareholders may request additional explanation regarding product changes and associated effects. Organizations may find it beneficial for their call center staff to receive advanced copies of mailings and messages regarding product lineup changes and related effects prior to distribution to shareholders.

Additionally, some organizations indicated that they may designate subject matter experts for money market fund reform in general, and floating NAV money market funds in particular. Housed in fund operations, this staff would be in place through the transition and into the first months following implementation. These resources may be drawn from those individuals tasked to implement money market fund reform, operationally, for the organization.

Funds and intermediaries face significant challenges in ensuring a smooth implementation of money market fund reforms, including the introduction of the four-decimal floating NAV. Successful implementation will require a comprehensive education and communication plan to transition into the new money market fund environment for shareholders and the fund and intermediary associates that service them.

