Liquidity Fee and Redemption Gate

Event Processing Assumptions and Considerations

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I. Introduction

Background

In July 2014, the Securities and Exchange Commission (SEC) adopted amendments to the 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.

The amendments give money market fund boards new tools to stem heavy redemptions by giving them discretion to impose a liquidity fee or gate if a fund's weekly liquid assets fall below the required regulatory threshold. The amendments also require all nongovernment money market funds—including money market funds with floating net asset values (NAVs)—to impose a liquidity fee if the fund's weekly liquid assets fall below a designated threshold, unless the fund's board determines that imposing such a fee is not in the best interests of the fund. The SEC explains that fees and gates are intended to enhance money market funds' ability to manage and mitigate potential contagion from high levels of redemptions and make redeeming investors pay their share of the costs of the liquidity that they receive. The SEC acknowledges, however, that fees and gates will rarely be imposed during normal market conditions.

Any fee or gate must be lifted automatically after the money market fund's level of weekly liquid assets rises to or above 30 percent, but can be lifted or altered at any time before that point if the board (including a majority of independent directors) determines that imposing such liquidity fee or gate is no longer in the best interests of the fund.

An ICI industry working group developed this document to outline assumptions, common practices, and considerations related to the imposition, removal, or revision of a liquidity fee or redemption gate for money market mutual funds and their intermediary partners.

Communication Considerations

Clear, concise, and timely communication is imperative once a money market fund's board has determined to implement a liquidity fee and/or redemption gate. All communications should be consistent and fair so as not to disadvantage any party. Any communications to shareholders and intermediaries regarding a fee or gate event should coincide with announcements posted to the fund's website and social media outlets. Proactive communication among funds, intermediaries, service providers, and shareholders will assist all parties during the implementation process.

In the majority of cases, it will be necessary for the fund to communicate the imposition of a fee/gate **after** the effective time/date; however, when possible, funds will communicate the imposition of a fee/gate in advance of the effective time/date.[1]

To aid in the development of a communication plan, ICI has identified a number of common communication objectives that fund complexes should consider. Those considerations are discussed in detail in ICI's **Communications Considerations: Liquidity Fees, and Redemption Gates** document.

II. Considerations: Predetermined in Advance of Event

From an operational aspect, implementation of a liquidity fee and/or redemption gate is a complicated and multifaceted endeavor. Furthermore, the rule allows for a liquidity fee and/or redemption gate to be implemented at any point including intraday, adding to the operational challenges.[2] It is imperative, therefore, for funds and intermediaries to work together when applying or removing (or, in the case of a liquidity fee, revising) a liquidity fee or redemption gate. To facilitate those efforts and to ease the burden at the time of the actual event, funds and intermediaries should reach an understanding on a number of considerations before the October 2016 effective date of the money market fund reform regulations. These include:

a. establishing a communication plan;

b. determining responsibility for application of fees/gates;

c. handling of transactions during the event; and

d. expectations relating to the estimate and remittance of liquidity fees.

Each of these considerations is discussed in more detail on the next pages.

[1] Application of a fee and/or gate must be consistent, fair, and not advantage one party over another party. Therefore, application of a fee or gate at a future date and time may not be appropriate or feasible.

[2] A money market fund that strikes multiple NAVs per day may experience additional complexities related to the application/removal (and revision, in the case of a liquidity fee) of a liquidity fee or redemption gate.

Communication Plan

As discussed above, clear, concise, and timely communication by the fund of a fee or gate to its shareholders and intermediary partners is imperative. Funds should have an established communication plan that includes:

a. processes and procedures for drafting event-related communications;

b. messages communicated;

c. entities responsible for disseminating the communication to appropriate parties (e.g., transfer agent, distributor);

d. parties receiving communications (e.g., shareholders, intermediaries, regulators);

e. communication platforms (e.g., website, letter, email, media);

f. communication methods (e.g., blast email/fax, any DTCC communication functionality that may be developed);

g. required regulatory filings, notices and disclosures;[3] and

h. timing of communication (e.g., retroactive or proactive).

Determine Responsibility for Application of Fee/Gate

Funds should reach an understanding with their intermediary partners regarding which party (fund's designated transfer agent or intermediary) will be responsible for the application/removal (and revision, in the case of a liquidity fee) of a liquidity fee or redemption gate. The responsibility for administering a fee or gate will generally follow the intermediary's trading model. For example, funds typically will not have the ability to look through an omnibus position to determine which underlying transactions would be affected by a fee or gate. As a result, the fund will require the intermediary to assume responsibility for implementing or removing a liquidity fee (or revision of a liquidity fee) and/or a redemption gate. To facilitate this conversation between funds and intermediaries, ICI had developed a tool (see next page) to outline common understandings regarding which entity is responsible for administering a fee or gate.

[3] Such as requirements relating to Form N-CR and Item 16(g) of Form N-1A.

Processing Responsibilities Matrix

	DIRECT-AT-FUND/ NETWORK LEVEL 0 OR 4	NETWORK LEVEL 3/TRUST PROCESSING[4]	OMNIBUS: AGGREGATE TRADING ACROSS TRANSACTION TYPES (NET/NET)[5]	OMNIBUS: AGGREGATED TRADING BY TRANSACTION TYPE[6]	OMNIBUS: INDIVIDUAL REDEMPTION TRANSACTIONS[7]	OMNIBUS: NON-AGGREGATED (INTERMEDIARY MAINTAINS CONTROL)
Application of gate	Fund applies	Fund applies	Intermediary applies	Fund applies based on time stamp provided on trade[8]	Fund applies based on time stamp provided on trade[9]	Intermediary applies
Assessment of liquidity fee	Fund assesses	Fund assesses	Intermediary assesses as appropriate	Fund assesses based on time stamp provided on trade[10]	Fund assesses based on time stamp provided on trade[11]	Intermediary assesses as appropriate
Remittance of liquidity fee	N/A as fund has assessed fee	N/A as fund has assessed fee	Intermediary provides estimate on trade date (prior to next NAV strike) as appropriate and remits fee to fund on T+2	N/A as fund has assessed fee	N/A as fund has assessed fee	Intermediary provides estimate on trade date (prior to next NAV strike) as appropriate and remits fee to fund on T+2

4 Trading is in a non-omnibus environment. Network level 3 or trust accounts trading in an omnibus environment should refer to the omnibus columns of this chart.

5 Daily trading is taking place on a net basis. The intermediary submits one trade representing the total net activity of all beneficial owners' underlying purchase/exchange-in and redemptions/exchange-out transaction activity.

6 Daily trading is taking place by transaction type. The intermediary submits one purchase transaction representing all underlying beneficial owners' purchase/exchange-in activity and one redemption/exchange-out transaction representing all underlying beneficial owners' redemption activity.

7 Intermediary submits individual redemption/exchange-out transactions for each underlying beneficial owner providing the fund with a full view of redemption/exchange transactions.

8 If a time stamp is not provided on a redemption or exchange-out transaction, the transaction is treated as though it were received after the implementation of the fee or gate. This means that the transaction will be subject to the liquidity fee or the redemption gate.

9 If a time stamp is not provided on a redemption or exchange-out transaction, the transaction is treated as though it were received after the implementation of the fee or gate. This means that the transaction will be subject to the liquidity fee or the redemption gate.

10 If a time stamp is not provided on a redemption or exchange-out transaction, the transaction is treated as though it were received after the implementation of the fee or gate. This means that the transaction will be subject to the liquidity fee or the redemption gate.

11 If a time stamp is not provided on a redemption or exchange-out transaction, the transaction is treated as though it were received after the implementation of the fee or gate. This means that the transaction will be subject to the liquidity fee or the redemption gate.

Handling of Transactions During the Event

Funds, with their intermediary partners, should consider how to handle certain transactions during a liquidity fee or redemption gate event. Transactions include:

a. Exchange transactions, in particular, an exchange out of the affected fund (and the related effect on the "to" fund): Consideration should be given to the impact on the purchase into the "to" fund or fund on the other side of the exchange transaction when a liquidity fee is assessed.[12] The total dollars exchanged into the new fund would be net of the liquidity fee.

b. In-flight transactions (transactions received by the intermediary but not by the fund): Which trade time stamp should be used (e.g., receipt of trade in good order by the intermediary or by the fund)?

c. Checkwriting transactions: Should checks written prior to the implementation (or removal) of a fee/gate but presented for payment after a fee/gate has been implemented (or removed) be honored as written or be affected by the fee/gate as appropriate?[13]

d. Debit card transactions: Should debit card transactions charged before the implementation (or removal) of a fee/gate but presented for payment after a fee/gate has been implemented (or removed) be honored as charged or be affected by the fee/gate as appropriate?[14]

e. Share class conversions (e.g., Class B to Class A share class rolls): How will a fee or gate affect a share class conversion transaction?

f. As-of transactions: As-of transactions will be affected by any fee or gate that was in place as of the trade date the transaction is to be processed.

g. Trade corrections: Trade corrections will be affected by any fee or gate that was in place as of the trade date that the trade correction is to be processed.

h. Defined Contribution Clearance Settlement Service (DCC&S)[15] transactions: DCC&S transactions may be affected by any fee or gate that is implemented between the time the third-party recordkeeper receives the transaction and the time the trade is received by the fund or its designated agent.[16]

i. Redemption fees: Should redemption fees be grossed up to cover a liquidity fee or taken out of remaining balance (i.e., for partial redemption)?

Liquidity Fee Expectation: Estimate and Remittance

The new rules allow a money market fund the flexibility to impose liquidity fees (up to 2 percent) and/or redemption gates (up to 10 business days in a 90-day period) after the fund's weekly liquid assets have crossed below 30 percent of its total assets, if the fund's board of directors (including a majority of its independent directors) determines that doing so is in the best interests of the fund.

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[12] It is assumed that a request for an exchange out of a gated money market fund would be rejected.

[13] See SEC 2014 Money Market Fund Reform Frequently Asked Questions, FAQ #28. See www.sec.gov/divisions/investment/guidance/2014-mmf-reform-faq-markup-v1.pdf

[14] See SEC 2014 Money Market Fund Reform Frequently Asked Questions, FAQ #28.

[15] DCC&S is an expansion of NSCC's Fund/SERV® platform that automates and simplifies the key processes involved in completing transactions for defined contribution and other retirement plans. See www.dtcc.com/investment-product-services/wealth-management-services/defined-contribution-clearance-and-settlement.aspx for additional information.

[16] DCC&S transactions are received by the intermediary on trade date in accordance with SEC Rule 22c-1 but generally received by the fund on trade date plus one (T+1) and processed as of the appropriate trade date.

The new rules also require a nongovernment money market fund, if its weekly liquid assets fall below 10 percent of its total assets, to impose a 1 percent liquidity fee on each shareholder's redemption, unless the fund's board (including a majority of its independent directors) determines that such a fee would not be in the best interest of the fund, or determines that a lower or higher fee (not to exceed 2 percent) would be in the best interests of the fund.

The intent of liquidity fees under the rule is to offset the costs of liquidity provided to redeeming shareholders and to protect the fund's NAV. Therefore, unlike short-term trader fees, applicable under SEC rule 22c-2, it is crucial that any intermediaries assessing a liquidity fee on behalf of a money market fund remit the fees to the fund immediately. Given that immediate remittance may not be possible, intermediaries that are responsible for application of a liquidity fee must provide the money market fund with an estimate of the liquidity fees assessed prior to the money market fund's next scheduled NAV calculation. This will allow the fund's accountant to book a receivable into the next calculated NAV.

Funds and intermediaries should agree on the method and format for providing the estimated amount of the liquidity fees assessed and for remittance of the monies to the money market fund for each trading day that the liquidity fee is in place. For example, the ICI industry working group expects that the intermediary will provide an estimate to the money market fund prior to its next scheduled NAV calculation and that the monies will be remitted to the fund no later than two business days following the trade date.

III. General Assumptions

The ICI industry working group identified several fundamental assumptions, outlined below, that apply to the administration of a liquidity fee and/or redemption gate.

Overall Assumptions

The fund's designated transfer agent and/or intermediary will systematically apply, revise, or remove a liquidity fee and/or redemption gate as determined by the money market fund board.

Redemption and exchange-out[17] requests will be rejected when a redemption gate is in place. Once the gate is lifted, shareholders/intermediaries will need to resubmit any redemption and exchange-out orders placed while the redemption gate was in effect.[18]

- Liquidity fee and redemption gate applicability will be determined based on a transaction's trade date and time stamp, not settlement.
- A liquidity fee will apply to any eligible debit transaction (redemption, exchange-out, systematic withdrawal payments [SWPs], checkwriting transactions, etc.)
- The trade time to use for automated transactions (preauthorized deposits [PADs], SWP, etc.) will be based on when the transaction is generated (typically at the end of day) and not when it was established.
- Liquidity fees or redemption gates will apply uniformly across all of a fund's share classes and transaction types.
- A transfer of ownership within the same fund/share class will be allowed in a gated fund/share class.

[17] Funds may want to consider whether purchase or exchange-in transactions for a gated fund will be accepted.

[18] See SEC 2014 Money Market Fund Reform Frequently Asked Questions, FAQ #24.

Assumptions Related to Omnibus Positions

- For omnibus intermediary positions—where the fund and intermediary have agreed that the intermediary assumes responsibility for implementing or removing a liquidity fee (or revision of a liquidity fee) and/or a redemption gate—the fund will maintain oversight responsibilities regarding the intermediary's processes and controls for implementing a fee or gate. In these situations the intermediary will be responsible for:

    a. implementing the liquidity fee and/or redemption gate;

    b. enforcing the liquidity fee and redemption gate requirements/parameters;

    c. assessing the liquidity fee;[19]

    d. providing the fund with an estimated amount of liquidity fees assessed per trade date before the fund calculates its next NAV;[20]

    e. remitting the fee to the fund in a timely manner (either upon settlement or no later than T+2);

    f. remitting the fee in a method or form agreed upon with the fund; and

    g. applying the fee or gate across plan level and super omnibus structures.

- For core sweep products, fees and gates will be determined by a transaction's trade date and time in relation to the liquidity fee/redemption gate effective time period (starting and ending date and time). For core sweep only, intermediaries may consider:

    a. removing the fund in fee or gate status from core processing;

    b. establishing a new core vehicle to replace the fund in fee/gate status; and

    c. using end-of-day netting of participant debits and credits to determine fee applicability.[21]

- Funds and intermediaries should include any oversight practices related to money market fund reform in their existing intermediary oversight programs. Therefore, any oversight activities related to money market reform should be an extension of, or incorporated into, a fund's or intermediary's existing processes and procedures. Oversight considerations may include:

    a. contractual amendments covering money market fund reform regulations;

    b. processes relating to controls testing included as part of third-party assurance reports (e.g., FICCA,[22] SSAE 16[23]);

[19] Omnibus positions that trade through Fund/SERV will use the fee remittance functionality to transmit liquidity fee confirmations and to remit the liquidity fee to the fund. See DTCC's Money Market Fund Reform Enhancements Concept paper for additional details.

[20] Estimates related to DCC&S transactions may not be received until T+2 due to the chain of intermediaries that are typically associated with defined contribution and retirement plan processing.

[21] See SEC 2014 Money Market Fund Reform Frequently Asked Questions, FAQ #27.

[22] A Financial Intermediary Controls and Compliance Assessment (FICCA) engagement—performed under American Institute of Certified Public Accountants (AICPA) attestation standards—requires an omnibus recordkeeper to engage an independent accounting firm to assess its internal controls relating to specific activities that the intermediary performs for its shareholder accounts. The auditor's report expresses an opinion on its evaluation of an intermediary's assertion that it has established specified control objectives and related controls that were suitably designed and operating effectively.

[23] SSAE 16 reports—prepared by an independent public accountant in accordance with the AICPA's Auditing Standards Board's Statement on Standards for Attestation Engagements No. 16, Reporting on Controls at a Service Organization—specifically are intended to meet the needs of the management and auditors of user entities, as they evaluate the effect of the controls at the service provider on the user entities' financial statement assertions.

c. existing certification or questionnaire processes; and

d. oversight activities relating to funds' use of DTCC NSCC Omni/SERV[24] or stand-alone DSA/DSP file feeds.

Assumptions Related to Non-Omnibus and Direct-at-Fund Positions

» For non-omnibus or direct-at-fund positions, the fund's designated transfer agent will systematically administer any liquidity fee or redemption gate. In these situations, the transfer agent will:

a. administer the fee or gate based on when the transfer agent receives the trade (not when the transfer agent processes the trade); and

b. remit any liquidity fees assessed to the fund.

IV. Other Considerations

In addition to the specific considerations listed above, funds and intermediaries should consider the impact of a fee or gate on the following:

a. call centers, including any up-front telephone messages created and/or scripts for personnel handling money market fund related inquiries;

b. voice response units (VRU), including any additional prompts or messaging;

c. website and all other trading mechanisms;

d. any internal educational/training materials necessary for operational and distribution staff (e.g., internal sales teams, wholesalers);

e. any required disclosures or filings;[25] and

f. any additional shareholder communications needed.

[24] The DTCC's NSCC Omni/SERV solution leverages DTCC connectivity to allow efficient transmission of related intermediary subaccounting activity and subaccounting position information to mutual fund companies. Omni/SERV files are based on layouts originally created and copywritten by an industry subaccounting provider and often referred to by their acronyms: DSA (subaccounting activity) and DSP (subaccounting position).

[25] See, e.g., requirements relating to Form N-CR and Item 16(g) of Form N-1A.