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♦ INDUSTRY CAUTIOUSLY OPTIMISTIC AFTER SEC REWRITES MMF RULES

Nearly six years after the Reserve Fund infamously "broke the buck" and more than four years after the money-fund industry and regulators implemented a series of fundamental reforms to money-market funds, a divided Securities and Exchange Commission voted 3-2 last week to require prime and tax-free institutional funds to float their net-asset-values and to allow fund boards to impose liquidity fees on early redeemers and to "gate" fund redemptions in times of market stress.

Characterizing the provisions of the final rule variously as "moderate," "balanced," and "fair," fund providers and associations were generally supportive in statements issued shortly after the July 23 vote. "The Commission has proceeded thoughtfully to craft a robust and meaningful final rule that will impose significant structural changes across the industry," stated Paul Schott Stevens, president and chief executive officer of the Investment Company Institute and one of the most vocal opponents of additional reforms. "While we may question some aspects of the rule as adopted, we strongly believe that the SEC has the long regulatory experience and deep technical expertise required to strike the proper balance, making money-market funds more resilient in times of financial stress while preserving the utility and value of these funds for investors."

Fidelity Investments, the largest money-fund provider by total assets, told investors that the company's "initial reaction is that the SEC has struck a reasonable balance," promising to "closely" evaluate the new rules and provide "further information and perspective on them soon." BlackRock and Vanguard responded similarly. Vanguard said the new rules would "preserve the value and utility that money-market funds provide to most individual investors." The Securities Industry and Financial Markets Association said it was "encouraged" that the SEC imposed the floating net-asset-value requirement mainly on prime institutional money funds and that the rule "appropriately reframed" the definition of retail funds to apply to "natural persons."

Not all market participants were so accommodating. "A floating NAV does not address run risk and would severely if not irreparably harm the viability of the product, taking away a key cash-management product and a primary source of funding for the commercial-paper market," maintained David Hirschmann, president and chief executive of the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness.

Hirschmann noted that the FNAV requirement in the SEC's June 2013 proposal had already caused many institutional investors to move assets out of money funds and into "less efficient products," and he said it was "highly likely" the SEC's final rule would exacerbate that trend. The failure of a proposed resolution issued by U.S. Treasury and Internal Revenue Service to fully address certain accounting and tax challenges posed by mandating a floating NAV "will both undermine the goal of the SEC's rule and have material implications for the cost-benefit analysis the SEC conducted," Hirschmann argued. He added that the Chamber will "consider all appropriate options as we carefully review the final rule; examining operational, accounting, and tax consequences."

Despite differences of opinion on the effects of the final rule's provisions, there is consensus that the money-fund industry is on the cusp of significant change. "Managing a money-market fund is becoming more complicated than ever," Joan Ohlbaum Swirsky of law firm Stradley Ronon Stevens & Young, told iMoneyNet, though observing that some approved provisions are more practical than those proposed last year, such as the "natural persons" retail-shareholder definition and allowing continued use of amortized-cost valuation by stable-NAV funds.

The combination of fees-gates and the floating NAV for institutional prime funds, however, "is a harsh combination," Swirsky noted, and the requirement that government funds hold 99.5 percent of portfolios in U.S. government securities "is quite strict."

A shorter 10 business-day duration and imposition of the redemption gate when weekly liquid assets drop to 30 percent of fund assets, rather than 15 percent as in the June 2013 proposal, will please some fund providers and displease others, Swirsky said. Virtually all fund providers will face myriad issues and challenges during the two-year implementation period, she noted, including the extent and destination of potential fund outflows, adjusting funds to meet the "natural-persons" definition, communicating with shareholders, and monitoring yields.

Moody's Investors Service and Fitch Ratings also foresee significant industry transformation. "The new rules represent the biggest changes to the MMF product characteristics since the inception of MMFs in the 1970s, with wide-ranging implications," Moody's Yaron Ernst noted. He said rule revisions would encourage more conservative fund management in order to minimize share-value fluctuations, and it will lead to "a smaller, more conservative and concentrated" fund industry. Similarly, Fitch observed that the new rule "will reshape the landscape of liquidity products for cash investors."

The new rule is far from perfect, Niels Holch, partner at law firm Holch & Erickson, told iMoneyNet. "Although I agree that defining a retail investor as a natural person is a much more practical approach and easier to implement," Holch said, "the SEC disappointed me in that the rule didn't provide funds or intermediaries with additional tools to see through the aggregated data provided by so-called omnibus accounts to assure that the beneficial owners in those funds are natural persons." The agency acknowledged the difficulty of achieving full transparency, Holch said, "but they just didn't mandate the tools, and that's disappointing."

For the most part, however, fund sponsors feel the reform process worked, Rick Holland, money-market funds managing director and a client portfolio strategist at Charles Schwab, told iMoneyNet. "Let's keep in mind that we have 2.6 trillion reasons to be optimistic about the money-fund industry, and that the benefits provided by money funds will continue to make the product unique and, importantly, very desirable," he said.♦

MFR COMMENTARY

Net assets of 1,010 Taxable MMFs increased $2.80 billion to $2.333 trillion as of July 29. Total Taxable Institutional fund assets rose $3.25 billion. Taxable Retail fund assets fell by $447.5 million.

The iMoneyNet Money Fund Average™/All Taxable 7-Day Yield remained at 0.01 percent for the 63rd straight week. The All Taxable 30-Day Yield remained at 0.01 percent for the 60th consecutive week. The Taxable WAM shortened to 43 days from 44 days the previous week.

Net assets of 418 Tax-Free and Municipal MMFs were down by $908.2 million, lowering their total to $255.84 billion as of July 28.

The iMoneyNet Money Fund Average™/All Tax-Free 7-Day Yield was unchanged at 0.01 percent for the 65th consecutive week. The All Tax-Free 30-Day Yield remained at 0.01 percent for the 83rd straight week. The Tax-Free WAM held steady at 35 days.

A one-week increase of $1.89 billion brought total net assets of 1,428 Taxable and Tax-Free money funds to $2.589 trillion.