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Changing complexities

New regulations and a shifting rate environment offer opportunities to liquidity investors

J.P.Morgan
Asset Management

ABOUT

J.P. MORGAN GLOBAL LIQUIDITY

J.P. Morgan Global Liquidity creates long-term, strategic relationships with our clients. Drawing on J.P. Morgan's global resources and expertise, we bring value to these relationships through extensive liquidity management capabilities that are global in reach and relentless in risk control. A broad range of short-term fixed income strategies is designed to meet our clients' specific operating, reserve and strategic cash management needs. Seasoned investment professionals provide actionable insights to help clients navigate shifting market environments and evolving regulatory regimes.

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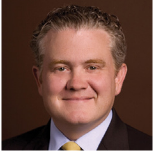
FOREWORD



ANDREW LINTON

IN JULY 2014, THE SECURITIES AND EXCHANGE COMMISSION (SEC) APPROVED SUBSTANTIAL CHANGES TO THE RULES GOVERNING MONEY MARKET FUNDS (MMF). Several take effect in October 2016. As investors adapt to the new regulatory environment, they are re-evaluating their liquidity strategies and considering their investment options.

Regulatory changes will unfold in a market environment in which interest rates, industry flows and portfolio security supply/demand dynamics may be very much in flux. As the Federal Reserve (Fed) resumes monetary policy normalization, it will likely change the yields of, and the spreads between, prime and government MMFs. And apart from the SEC's MMF reform, other global financial regulations, most notably Basel III, will impact the relative attractiveness of MMFs as compared with bank deposits.

As liquidity investors contemplate these sometimes countervailing forces, they should know that MMF reforms, beginning with those adopted in 2010 (amendments to Rule 2a-7 under the Investment Company Act of 1940), have made the industry stronger and more transparent. Two key changes approved in July 2014 are effective as of October 2016, following a two-year transition period:

- Institutional prime and municipal MMFs must float their market-based net asset values (NAV) by executing sales and redemptions based on the current market values of the securities in their portfolios, rounded to the fourth decimal place. (Institutional funds are defined as non-retail funds; retail funds must limit their beneficial owners to "natural persons.")
- The board of trustees of an MMF may impose a liquidity fee or gate if the fund's weekly liquidity assets fall below 30% of total assets. Government MMFs are not required to be subject to the fee and gate provisions.

In the following pages, we discuss the substance of the SEC's reforms, explain how they help to protect investors and strengthen stability in short-term fixed income markets, and explore how liquidity investors can craft the most-effective strategies for their own particular risk tolerances and return objectives.

Andrew Linton
Managing Director
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In 2010, a first wave of reform

After the Reserve Primary Fund "broke the buck" the day after Lehman Brothers filed for bankruptcy in September 2008 (the fund's NAV fell below $1.00 per share), and contagion spread through the MMF sector, regulators focused on the need for added safeguards to protect investors and reduce the risk of systemic financial stress.

Far-reaching regulatory reforms enacted in 2010 as amendments to Rule 2a-7 under the Investment Company Act of 1940 significantly strengthened the sector, addressing the following issues:

Liquidity

- For all taxable MMFs, at least 10% of assets are required to be held in cash or Treasury securities that can be converted into cash within one day.
- For all MMFs, at least 30% of assets are required to be held in cash, Treasury securities of any maturity, certain other government securities that have a remaining maturity of 60 days or less, or securities that will mature or can be converted into cash within five business days.
- No more than 5% of an MMF's portfolio can be held in illiquid securities, which include any security that cannot be sold or disposed of within seven days at carrying value.

Credit quality

- MMFs are limited to investing no more than 3% of assets in second-tier securities, generally defined as securities that have not received a short-term rating in the highest category from two Nationally Recognized Statistical Rating Organizations (NRSRO), or one NRSRO if only one rating is present, or have been deemed to be of comparable quality by the fund.
- MMFs are limited to investing no more than one-half of 1% of assets in second-tier securities issued by any single issuer.
- MMFs cannot acquire any second-tier security with a remaining maturity greater than 45 calendar days.

Repurchase agreements

In repurchase agreements (repo), money market funds can "look through" the repo counterparty to the underlying collateral pool when measuring portfolio diversification as long as the collateral consists of cash or government securities and the repo is collateralized fully; under the 2010 reforms, MMFs are also required to evaluate the creditworthiness of the repo counterparty.

Periodic stress tests

MMFs are required to perform certain periodic stress tests. These tests use hypothetical stress events, such as a sudden change in interest rates, to seek to ensure that an MMF can expect to maintain a stable NAV.

New SEC rules further strengthen the sector

TRANSPARENCY

New disclosure and reporting requirements significantly increase transparency, giving investors clear and timely access to information about their funds' investments.

- Portfolio holdings (as reported to the SEC on Form N-MFP) will be immediately available to the public upon filing. Currently, the information is available monthly on a 60-day delay. Many MMFs already disclose holdings monthly on their websites and daily upon client request.

It is important to note that new disclosure requirements may help to reduce risk in MMFs and can deepen understanding of the funds' characteristics and practices, making shareholders better informed about their investments. This may lead to lower volatility during times of stress.

ADDITIONAL MANDATORY DISCLOSURE

- All money market funds must post a six-month rolling history, updated daily, of the following: daily and weekly liquidity levels, net shareholder inflows and outflows, and market-based NAVs per share. (This rule took effect in April 2016.)
- Imposition or removal of fees or gates, portfolio security defaults, and sponsor or fund affiliate support must be promptly disclosed in a new Form N-CR and on a fund's website. (This rule took effect in July 2015.)
- An MMF's statement of additional information (SAI) will be required to disclose any occasion on which a fund received sponsor support. (This rule took effect in April 2016.)

RISK CONTROLS

Additional risk controls will strengthen MMFs and bolster investor protections.

- **Diversification:** No more than 10% of an MMF's total assets can be subject to guarantees or demand features from a single institution. Previously, this limit applied to 75% of a fund's portfolio, leaving a 25% basket. For tax-exempt MMFs, the limit basket was reduced to 15%.
- **Aggregate affiliated entities:** MMFs may not invest more than 5% in any single issuer or group of affiliated issuers. Previously, the 5% limit did not apply to groups of affiliated issuers.
- **Enhanced stress testing:** More-robust stress testing requirements will seek to eliminate disparities in the industry's existing stress tests and arm MMF boards with more-comprehensive, higher-quality reports, giving boards better tools to judge the health of their funds, especially in times of stress.

A floating, market-based NAV: What does it mean, how will it work?

DEFINING THE DIFFERENCE: STABLE NAV VS. MARKET-BASED NAV

Although both stable NAVs and market-based NAVs seek to reflect the value of funds' portfolios, they represent different calculations. Money market funds currently calculate a $1.00 stable NAV by using the amortized cost accounting method, in which portfolio securities generally are valued at cost plus any amortization of premium or accretion of discount. MMFs can use this method only if certain conditions of the SEC's Rule 2a-7 are met. One condition stipulates that the fund's board of trustees continues to believe that the amortized cost valuation fairly reflects the market-based NAV per share of the fund. Because this regulation also requires money market funds to hold very short-term, high-quality securities, the amortized cost method usually provides a close approximation of the fund's market-based NAV. However, it may also result in periods during which the amortized cost value of a portfolio security is different from the price the fund would receive if it sold its underlying investments.

MARKET-BASED NAVs ARE NOT NEW, BUT THEY ARE MORE AVAILABLE

Money market funds have long calculated their market-based NAV out to four decimals (for example $1.0000). The SEC's 2010 money market fund reforms required MMFs to report this four decimal NAV to the SEC as of the end of each month and disclose that value to the public on a 60-day lag. Though they were not compelled to do so, in the past few years, a number of money market fund providers, including J.P. Morgan Asset Management, began publicly disclosing market-based NAVs on the next business day.

While the market-based NAV has been calculated and disclosed for years, it is only with the 2014 SEC reforms that money market funds must use market-based NAVs for transactions in institutional prime and municipal funds.

With the new reforms in 2014, institutional prime and municipal MMFs now must not only calculate and disclose the market-based NAV out to four decimals, they must transact at this NAV. This means that even small fluctuations will impact shareholders. They may take a small gain or loss on positions that are sold while the NAV is above or below the $1.0000 threshold.

MARKET-BASED NAVs FLUCTUATE FOR A VARIETY OF REASONS

Fluctuations in the market-based NAV, above or below $1.0000, can be common but have typically been small.

These fluctuations can occur as the result of changes in market interest rates, changes in credit spreads, inflows and outflows of money, and ratings downgrades or defaults on securities held in the portfolio.

Still, even in volatile markets, since 2010, MMF shares have generally maintained values near $1.0000. This is partly because of the SEC's strict requirement that money market funds hold very short-term, high-quality securities. A rigorous focus on risk management and credit analysis can further help restrain the movement of market-based NAV to a narrow band (see **Exhibit 1** for a chart of historical market-based NAVs).

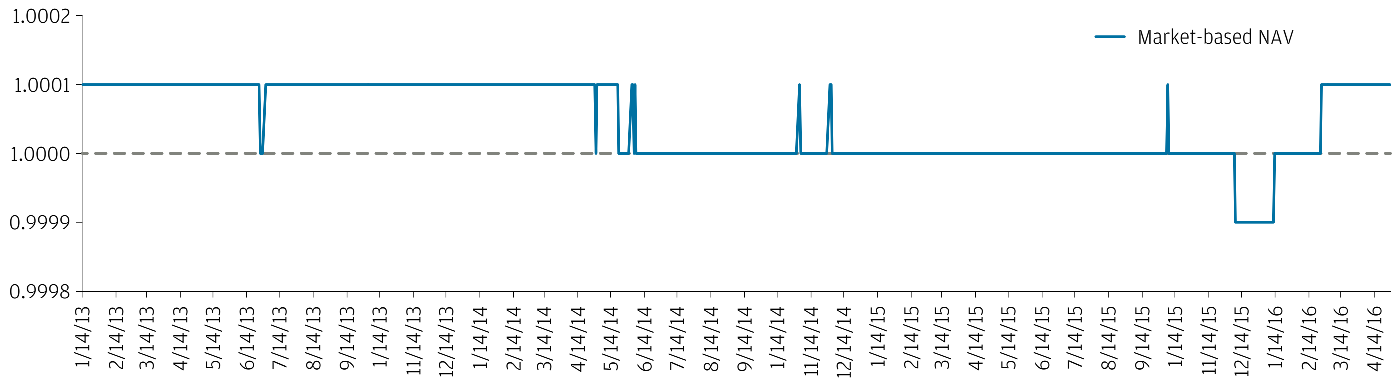
RISK OF POTENTIAL LOSSES WITH A FLOATING, MARKET-BASED NAV

Investors will also face a risk of incurring a loss or gain if they sell their fund shares on a day on which the floating NAV has deviated from $1.0000 per share. (An investor will also incur a loss or gain if selling below or above the purchase price.) Under normal circumstances, the portfolio of the fund would be subject to the same risk limitations as retail MMFs, and the extent of these deviations has historically been small.

CASH AND CASH EQUIVALENTS

In its adopting release, the SEC stated that "the adoption of a floating NAV alone for certain Rule 2a-7 funds will not preclude shareholders from classifying their investments in money market funds as cash equivalents, under normal circumstances, because fluctuations in the amount of cash received upon redemption would likely be small and would be consistent with the concept of a 'known' amount of cash."

EXHIBIT 1: ILLUSTRATIVE FUND DAILY HISTORICAL MARKET-BASED NAVS[1]



Source: J.P. Morgan Asset Management; data as of April 30, 2016. For illustrative purposes only.

[1] This amount is the market-based net asset value per share (NAV) of the JPMorgan Prime Money Market Fund calculated using current market quotations (or an appropriate substitute that reflects current market conditions) to value its NAV to four decimal places (market-based NAV). The Fund does not currently transact using its market-based NAV.

Note: The JPMorgan Prime Money Market Fund began disclosing its market-based NAV on a next-business-day basis on January 14, 2013.

In the chart shown above, the market-based NAV for the JPMorgan Prime Money Market Fund on January 14, 2013 was 1.0001. This means that the value of the portfolio's underlying securities was one-hundredth of a penny greater than the stable $1.00 NAV at which it transacted.

Tax relief for shareholder reporting

Proposed rules issued by the Department of Treasury, along with tax guidance from the Internal Revenue Service (the Guidance), clarify and simplify tax reporting for shareholders redeeming shares in floating NAV money market funds. The rules address the calculation of gains and losses, wash sales and information reporting. Though the rules are not final, Treasury has said that taxpayers may rely upon them now. As always, shareholders should consult a tax advisor for counsel about their specific tax situations.

CALCULATION OF GAIN OR LOSS

Generally, shareholders in floating NAV funds may use a simplified method of calculating gain or loss, the net asset value method (NAV method). Under this method, gain or loss is calculated for a computation period (a taxable year or any number of months, weeks or days) rather than for each redemption. The capital gain or loss for a computation period (accounted for as a short-term gain or loss) equals the value of shares at the end of the period less the cost basis of shares at the beginning of the period plus the net investment (including reinvested dividends) during the period. Once the NAV method is adopted, it must be applied to all investments in floating NAV MMFs and cannot be changed without IRS consent.

On pages 6 and 7 we illustrate this simplified method, presenting a case study of an investor with $4 billion in balance sheet cash.

WASH SALE RULES

Under the terms of wash sale rules, a loss must be deferred when a shareholder redeems shares at a loss and then acquires the same shares within 30 days before or after the redemption. The Guidance exempts the redemption of floating NAV MMF shares from these wash sale rules.

SHAREHOLDER INFORMATION REPORTING

The Guidance extends the existing exemption from information reporting rules for money market funds to floating NAV MMF—that is, no Form 1099-B reporting would be required.

In the case study below and on the following page, we profile an investor with $4 billion in balance sheet cash, illustrating the results of calculating a gain or loss on an annual, quarterly and monthly basis using the NAV method.

CASE STUDY: NAV METHOD—*Annual calculation*

Investor profile

Client size: $4 billion in balance sheet cash
Calculation period: Annual; tax year ending December 31

Period rationale: Volatile transaction base. Typically holds a large operating cash balance. Reports investment gain/loss annually.

Annual calculation

ENDING BALANCE – NET FLOWS – BEGINNING BALANCE = NET GAIN/(LOSS) X TAX RATE = (TAX BENEFIT)/LIABILITY

	Values	Calculations
Ending balance	2,332,236,626.93	Ending shares x NAV
		2,332,236,626.93 x 1.0000
Net flows	(322,656,910.85)	Purchases – Redemptions + Income Reinvestment
		11,922,500,000.00 (shares x NAV) - 12,246,000,000.00 (shares x NAV) + 843,089.15 (shares x NAV)
Beginning balance	2,654,709,918.52	Beginning shares x NAV
		2,654,709,918.52 x 1.0000
Net gain/(loss)	183,619.26	
Client's applicable tax rate	35%	
(Tax benefit)/liability	64,266.74	Net Gain/(Loss) x Applicable Tax Rate

Transactions[2]

Transaction type	Trade date	$ amount purchased/(redeemed)	NAV	Shares	Share balance
Income reinvestment	12/31/2013	108,899.12	$1.0000	108,899.12	2,654,709,918.52
Purchase	01/1/2014	48,000,000.00	$1.0001	47,995,200.48	2,702,705,119.00
Purchase	01/6/2014	30,000,000.00	$1.0001	29,997,000.30	2,752,700,119.50
Redemption	01/8/2014	(111,000,000.00)	$1.0001	-110,988,901.11	2,641,711,218.39
Income reinvestment	12/31/2014	96,495.11	$1.0000	96,495.11	2,332,236,626.93
....	....	....	....	....	....
....	....	....	....	....	....
Total net flows		(322,656,910.85)			

[2] Transactions presented are only a portion of total transactions used in illustrative calculations.

Source: Proposed Treasury Regulation Section 1.446-7, Internal Revenue Service. For illustrative purposes only. All calculations are hypothetical.
JPMorgan Chase & Co. and its affiliates do not provide tax advice. Please seek the advice of a tax professional.

CASE STUDY: NAV METHOD—*Quarterly calculation*

Investor profile

Client size: $4 billion in balance sheet cash
Calculation period: Quarterly; tax year ending December 31

Period rationale: Quarterly reporting required, cyclical business or quarterly cash flow changes.

Quarterly calculation

(TAX BENEFIT)/LIABILITY = ([QUARTER 1 NET GAIN/(LOSS)] + [QUARTER 2 NET GAIN/(LOSS)] + [QUARTER 3 NET GAIN/(LOSS)] + [QUARTER 4 NET GAIN/(LOSS)]) x TAX RATE

	First quarter	Second quarter	Third quarter	Fourth quarter
Ending balance	1,480,492,540.41	1,605,510,455.04	1,747,012,564.55	2,332,236,626.93
Ending shares x NAV	1,480,492,540.41 x 1.0000	1,605,510,455.04 x 1.0000	1,747,012,564.55 x 1.0000	2,332,236,626.93 x 1.0000
Net flows	(1,174,482,849.10)	125,169,259.41	141,432,616.46	585,224,062.38
Purchases	*1,750,500,000.00*	*3,103,000,000.00*	*3,545,000,000.00*	*3,524,000,000.00*
(Redemptions)	*(2,925,300,000.00)*	*(2,978,000,000.00)*	*(3,403,700,000.00)*	*(2,939,000,000.00)*
Income reinvestment	*317,150.90*	*169,259.41*	*132,616.46*	*224,062.38*
Beginning balance	2,654,709,918.52	1,480,492,540.41	1,605,510,455.04	1,747,012,564.55
Beginning shares x NAV	2,654,709,918.52 x 1.0000	1,480,492,540.41 x 1.0000	1,605,510,455.04 x 1.0000	1,747,012,564.55 x 1.0000
Net gain/(loss)	265,470.99	(151,344.78)	69,493.05	0.00
Annual net gain/(loss) =	265,470.99 + (151,344.78) + 69,493.05 + 0.00 = 183,619.26			
(Tax benefit)/liability = annual net gain/(loss) x 35% =	183,619.26 x 35% = 64,266.74			

CASE STUDY: NAV METHOD—*Monthly calculation*

Investor profile

Client size: $4 billion in balance sheet cash
Calculation period: Monthly; tax year ending December 31

Period rationale: Monthly reporting required, monthly books must be closed or other monthly requirements.

Monthly calculation

(TAX BENEFIT)/LIABILITY = ([MONTH 1 NET GAIN/(LOSS)] + [MONTH 2 NET GAIN/(LOSS)] + [MONTH 3 NET GAIN/(LOSS)] ... [MONTH N NET GAIN/(LOSS)]) X TAX RATE

	January	February	March	April
Ending balance	2,665,091,261.22	2,847,719,878.58	1,480,492,540.41	1,788,536,358.75
– Monthly net investment	*10,115,871.71*	*182,628,617.36*	*(1,367,227,338.17)*	*308,043,818.34*
– Beginning balance	*2,654,709,918.52*	*2,665,091,261.22*	*2,847,719,878.58*	*1,480,492,540.41*
Net gain/(loss) =	265,470.99	–	–	–
	May	**June**	**July**	**August**
Ending balance	2,241,599,136.08	1,605,510,455.04	1,440,926,453.69	1,903,963,567.37
– Monthly net investment	*453,062,777.33*	*(635,937,336.26)*	*(164,664,593.29)*	*463,048,212.57*
– Beginning balance	*1,788,536,358.75*	*2,241,599,136.08*	*1,605,510,455.04*	*1,440,926,453.69*
Net gain/(loss) =	–	(151,344.78)	80,591.94	(11,098.89)
	September	**October**	**November**	**December**
Ending balance	1,747,012,564.55	1,730,068,674.10	2,544,140,131.82	2,332,236,626.93
– Monthly net investment	*(156,951,002.82)*	*(16,943,890.45)*	*814,071,457.72*	*(211,903,504.89)*
– Beginning balance	*1,903,963,567.37*	*1,747,012,564.55*	*1,730,068,674.10*	*2,544,140,131.82*
Net gain/(loss) =	–	–	–	–
Annual net gain/(loss) =	265,470.99 + 0.00 + 0.00 + 0.00 + 0.00 + (151,344.78) + 80,591.94 + (11,098.89) + 0.00 + 0.00 + 0.00 + 0.00 = 183,619.26			
(Tax benefit)/liability = annual net gain/(loss) x 35% =	183,619.26 x 35% = 64,266.74			

Source: Proposed Treasury Regulation Section 1.446-7, Internal Revenue Service. For illustrative purposes only. All calculations are hypothetical.
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Defining liquidity fees and redemption gates

Under the new SEC rules, if an MMF's level of weekly liquid assets falls below 30% of total assets, the regulatory minimum, the MMF board has the authority to impose a liquidity fee of up to 2% on all redemptions—if the board determines that such a fee is in the fund's best interests. If an MMF's level of weekly assets falls below 10% of total assets, its board is required to impose a liquidity fee of 1% on all redemptions. However, the 1% fee need not be imposed if the board concludes that such a fee is not in the fund's best interests or if it determines that a lower or higher fee (up to 2%) is more appropriate.

As stipulated by the new SEC rules, if an MMF's level of weekly assets falls below 30%, the fund's board can temporarily suspend redemptions (impose a gate) if it judges that it is in the fund's best interests. The gate can stay in place no longer than 10 business days, but it can be lifted earlier. An MMF board cannot impose a gate for more than 10 business days in any 90-day period. As we have noted, the board is not required to impose a fee or gate at any liquidity threshold if it is not in the fund's best interests.

UNDER NEW SEC RULES, A GATE NEED NOT RESULT IN FUND LIQUIDATION

The new rules differ from 2010 regulations in several important respects. Previously, MMFs could suspend redemptions if, subject to other requirements, the fund's board determined that the deviation between the fund's amortized cost per share and its current net asset value per share might result in material dilution or other unfair results to shareholders. At that point, the MMF would have to move to liquidate the fund.

Under the amendments, subject to certain conditions, an MMF can gate redemptions for up to 10 business days in a 90-day period—but it does not have to move to liquidation. MMF boards retain the authority to permanently suspend redemptions and liquidate an MMF under Rule 22e-3.

FUNDS WILL STRIVE TO AVOID GATES

Gates and liquidity fees can be powerful tools, enabling MMF boards to provide shareholders with stability and equitable treatment in times of stress. A gate will effectively and definitively stop a run on an MMF, giving its board time to react to the situation at hand.

Will a board always opt to impose a fee or a gate when the level of weekly liquid assets falls below the 30% threshold? Not necessarily. In most cases, the specific situation the fund finds itself in will determine whether the board chooses to impose the fee or gate. Certainly, MMFs may currently fall below a 30% threshold without experiencing a meaningful liquidity issue. For example, a temporary increase in cash flow volatility may bring the liquidity level to 29%, say, but 4%–5% of a portfolio may be maturing over the following two weeks. In that case, the fund's liquidity position would appear to be quite solid.

Beyond regulation: Rates, flows, supply/demand dynamics

Regulatory changes will unfold in a market environment in which interest rates, industry flows and portfolio security supply/demand dynamics may be very much in flux.

Institutional liquidity investors that want to avoid a floating NAV, fee or gate may find government MMFs increasingly attractive. We anticipate that more money will continue to move into government MMFs; we expect the bulk of the inflows in the second half of 2016. This could lead to a challenging supply picture, as eligible holdings for government MMFs become scarce relative to demand. The Federal Reserve Bank of New York's (FRBNY) reverse repurchase agreement (RRP) program has provided a meaningful backstop source of investible supply for MMFs, limited only by the value of the System Open Market Account's (SOMA) holdings of Treasury securities (~$2 trillion). The RRP program has put a loose floor on short-term rates at the Fed's current lower-bound target of 25bps.

Helping to improve the overall supply picture, the supply of U.S. Treasuries is poised to grow in the second half of 2016, reflecting continued issuance of Treasury floating rate notes, Treasury coupons that are rolling into the MMF space, as well as a planned increase in Treasury bill issuance. Still, questions persist regarding potentially insufficient supply of short-term high-quality issuance to meet growing demand from liquidity investors looking for stable NAV products.

Increased demand for MMFs will come in part from investors moving out of bank deposits. Some of that shift will reflect the fact that Basel III standards for bank capital, liquidity and leverage make it less attractive for banks to hold deposits deemed to be non-operating cash; banks have already begun to push these deposits off-balance sheet. (For further background, see J.P. Morgan Global Liquidity's "Liquidity Investors and Basel III.")

As stronger demand for government MMFs pressures yields lower and waning demand for prime MMFs pushes yields higher, some institutional investors may re-evaluate the relative attractiveness of government and prime MMFs. The yield differential between government and prime MMFs may widen enough to cause a shift of assets back into prime MMFs.

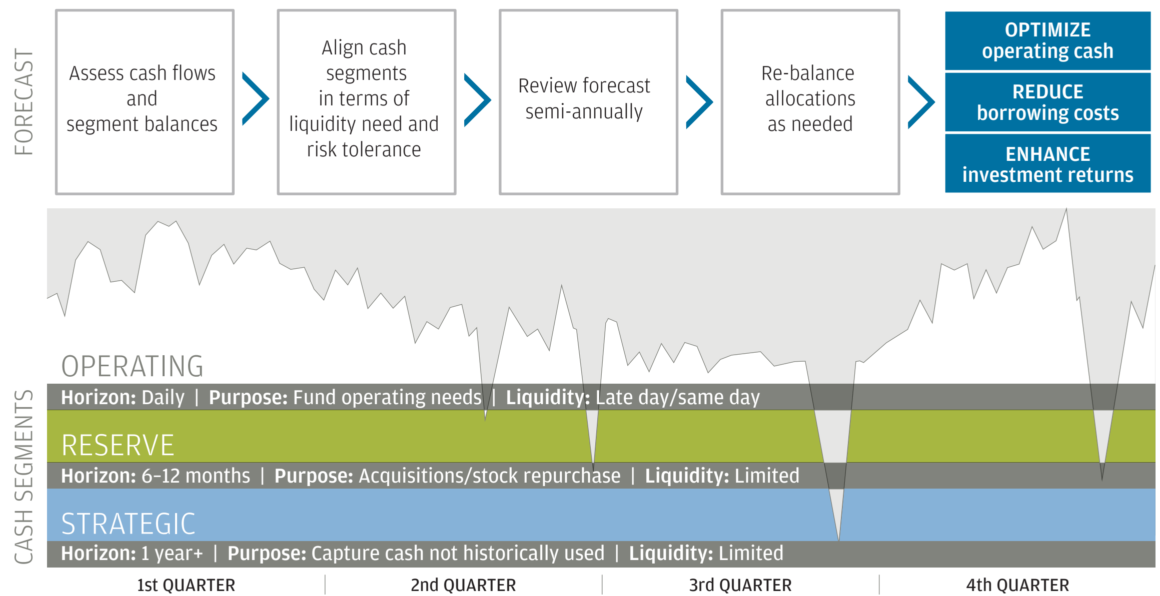
Reassessing an investment strategy in a shifting market and regulatory environment

If their investment policies permit it, some liquidity investors may decide to move beyond MMFs. They may move into ultra-short funds, with investment horizons of about six months, or short-term bonds funds, with investment horizons of one year or longer. As always, investors are well advised to think strategically about cash segmentation, identifying what cash must be immediately available and forecasting potential surplus cash.

An organization looking to most effectively segment its cash must first create a reliable and detailed "cash forecast" (**EXHIBIT 2**). The precise detail captured in that forecast will depend on how much visibility a business has on its cash flows. Ideally, a treasury team will try to ascertain when and where surplus cash is held in the organization, how much of it is available and for how long.

Categorizing each of these pools can enable organizations to determine their priorities for liquidity and investment return. Operating cash could require daily liquidity, whereas reserve cash could be invested with a six- to twelve-month horizon; the horizon for strategic cash could extend to a year or longer (**EXHIBIT 3**).

EXHIBIT 2: ACCURATELY FORECASTING AND SEGMENTING CASH BALANCES

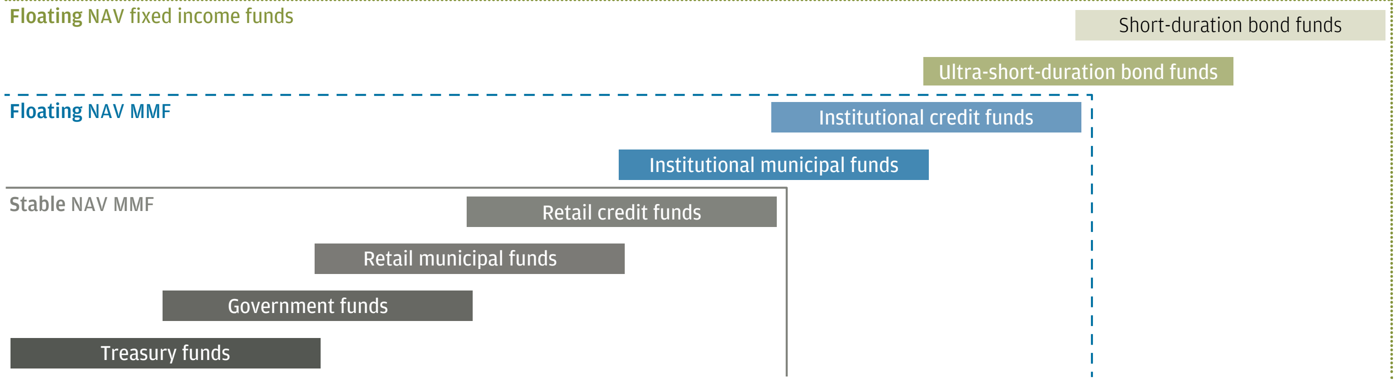


Source: J.P. Morgan Asset Management. The chart is shown for illustrative purposes only.

These categories are presented as examples of cash segmentation; an organization may choose to characterize its cash pools quite differently. Whatever method is adopted, formally allocating cash into different segments can give an organization the ability to identify an appropriate investment strategy for each cash pool. Across all cash segments, investors should choose the vehicles that best meet their liquidity requirements, risk tolerance and investment return objectives.

In this context we underscore the importance of reviewing an investment policy to reflect operational changes to MMFs and to allow for liquidity alternatives such as private placements. Especially in a new regulatory environment, organizations will need flexibility in their investment policies to take advantage of evolving opportunities.

EXHIBIT 3: TYPICAL U.S. SHORT-TERM FIXED INCOME INVESTMENT SOLUTIONS



Source: J.P. Morgan Asset Management. For illustrative purposes only.

KEY QUESTIONS TO ASK BEFORE INVESTING IN A MONEY MARKET FUND

SPONSOR

- Have you evaluated the strength of the MMF sponsor?
- What is the scope of your overall relationship with the MMF sponsor?
- Does the MMF business reside in a diversified fixed income and asset management business?
- Has the fund sponsor garnered assets during times of market instability?

CREDIT/INVESTMENT PROCESS

- Have adequate resources been allocated: size of team, tenure (industry and firm), global location, sector experience, monitoring systems?
- What is the level of access to portfolio managers and credit analysts?
- Has the fund had to step in to buy out any securities or provide liquidity to a fund?
- What is the underlying investment diversification?

LIQUIDITY

- What are the key service features: late cutoff times, Internet capability, ease of use?
- How diverse is the client base of the fund sponsor?
- Have you evaluated the liquidity profile of the fund?
- Has the fund ever restricted withdrawals?

Conclusion

The new SEC rules governing money market funds are designed to provide greater protection to investors and do not change the function or eliminate the utility of MMFs. Money market funds have previously calculated and disclosed their market-based NAVs, but now institutional prime and municipal MMFs will be transacting at these values. A thorough understanding of the new rules will help liquidity investors to make the most-knowledgeable decisions.

This understanding will be especially helpful as investors look to segment their cash, distinguishing among operating cash (requiring same-day liquidity), reserve cash (with an investment horizon of six to nine months or longer) and strategic cash (with an investment horizon of one year or longer). This approach will be most effective when organizations have sufficient flexibility in their investment policies to benefit from the opportunities presented by the new regulatory environment. Ultimately, cash segmentation coupled with a complete grasp of the new SEC rules will enable investors to create the most-effective liquidity strategies for their own particular risk tolerances and return objectives.

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