

Global Liquidity

U.S. Money Market Fund Reform

July 25, 2014

J.P. Morgan Global Liquidity remains committed to working with our clients to adapt to these changing times. We have partnered with regulators over the last several years and, under the new regulations, look forward to serving the needs of our clients by exploring and understanding their implementation concerns, analyzing investment options, and providing insights and solutions under the new requirements. As a leader in the global liquidity business, we will continue to strive to meet investors' liquidity management needs in the same way we have historically – with a prudently managed portfolio of liquid, high-quality money market instruments. In the coming months, we plan to communicate with you more details about these new rules and their implications.

Executive summary

On July 23, 2014, the Securities and Exchange Commission (SEC) approved changes to Rule 2a-7 under the Investment Company Act of 1940, which governs the operation of money market funds (MMFs). The amendments, which apply to U.S. registered MMFs, were approved by an affirmative vote of three out of five SEC Commissioners. The two most significant changes would:

- (i) require institutional prime and institutional municipal money market funds to float their net asset value (NAV) by executing sales and redemptions based on the current market value of the securities in their portfolios rounded to the fourth decimal place (e.g., \$1.0000) and
- (ii) permit the board of a money market fund, in its discretion, to impose a liquidity fee or temporarily suspend redemptions (gate) if the fund's "weekly liquid assets" falls below 30% of its total assets.

Under the amendments, government (retail or institutional), retail prime and retail municipal money market funds are permitted to continue to utilize amortized cost to value their portfolio securities and to seek to transact at their existing \$1.00 share price.

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Transition period

While the final rule¹ was adopted on July 23, 2014, there is a two year transition period (i.e., 3rd quarter 2016) for the amendments relating to floating NAV and imposition of liquidity fees and gates, measured from the date of publication of the amended rules in the Federal Register, which is expected to occur in the next few weeks.

As a result, the approved changes are not anticipated to have an immediate impact to the operation of our money market funds. The compliance date for some of the other changes, such as enhanced disclosure and reporting requirements, new diversification requirements and enhanced stress testing requirements, will be nine months from the publication of the rule, while for others it will be 18 months.

Floating NAV

Institutional prime and institutional municipal MMFs will be required to execute sales and redeem shares at a floating NAV based on the current market-based value of the securities in their underlying portfolios rounded out to the fourth decimal place (e.g., \$1.0000).

The U.S. Department of the Treasury and the Internal Revenue Service also issued tax guidance on July 23 that: (i) allows shareholders in floating NAV money market funds to use a simplified accounting method to track gains and losses and (ii) provides relief from certain “wash sale” rules for losses on shares of a Floating NAV money market fund.

Government, treasury, retail prime funds and retail municipal MMFs will continue to be able to seek to transact at a stable \$1.00 NAV as they do today by using amortized cost accounting to value their portfolio securities.

“Government” money market funds, which may include Treasury money market funds, are defined as a fund that invests at least 99.5% of its total assets (formerly 80%) in cash, government securities or repurchase agreements collateralized solely by cash and/or government securities.

Defining investor types

The amendments define “retail” and “institutional” money market funds based on the types of investors that are permitted to invest in the fund. “Retail” funds are defined as a money market fund that has policies and procedures reasonably designed to limit all beneficial owners of the fund to “natural persons” while “institutional” funds are defined as money market funds that are not retail funds.

¹ <http://www.sec.gov/rules/final/2014/33-9616.pdf>

Liquidity fees and redemption gates

The rules allow all money market funds to impose liquidity fees for investors to redeem shares or to temporarily block investors from withdrawing cash in times of stress.²

Liquidity Fees: If a money market fund's level of "weekly liquid assets"³ falls below 30% of its total assets, a money market fund's board has discretionary authority to impose a liquidity fee of up to 2% on all redemptions if it is in the fund's best interests. If the money market fund's weekly liquid assets decline below 10%, the money market fund *must* impose a liquidity fee of 1% on all redemptions, unless the funds' board determines that such a fee is not in the best interests of the fund or that a higher (up to 2%) or a lower fee would be in the best interests of the fund.

Gates: If a money market fund's level of weekly liquid assets falls below 30% of total fund assets, a fund's board, in its discretion, may temporarily suspend redemptions if it finds that imposing a gate is in the fund's best interests. A money market fund's board would not be able to impose a gate for more than 10 business days in any 90-day period.

While the amendments relating to fees and gates will apply to retail money market funds under the amendments, government money market funds, including Treasury money market funds, may voluntarily opt into them if they disclose to investors in advance that they will do so.

Portfolio diversification, disclosure and stress testing

The new rules also strengthen requirements for portfolio diversification, disclosures and stress testing for all money market funds, as well as update reporting requirements for money market funds and certain private liquidity funds that operate like money market funds.

² Note, our U.S. registered MMFs already post their level of weekly liquid assets each business day as of the prior business day.

³ Weekly liquid assets generally include cash, U.S. Treasury securities, certain other government securities with remaining maturities of 60 days or less and securities that convert into cash within one week.

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