Money Market Mutual Funds: Regulatory Change Review

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KEY TAKEAWAYS

- Final regulatory changes for money market mutual funds were effective October 14, 2016.
- The rules establish new definitions for government funds and retail funds, and require institutional prime and institutional municipal money market mutual funds to price and transact at a "floating" NAV.
- During periods of extraordinary market stress, both retail and institutional prime and municipal money market mutual funds may charge shareholders liquidity fees, and institute temporary redemption gates.
- Government and U.S. Treasury money market mutual funds continue to seek a stable $1.00 NAV and are not subject to fees and gates.
- Retail prime and municipal money market funds continue to seek a stable $1.00 NAV.

In 2014, the Securities and Exchange Commission (SEC) approved regulatory changes, effective October 14, 2016, for money market mutual funds (MMFs).

New rules

The rules establish new definitions for government MMFs and retail MMFs, and require institutional prime MMFs (also known as "general purpose") and institutional municipal MMFs to price and transact at a "floating" (or variable) net asset value (NAV). Also under the new rules, during periods of extraordinary market stress, retail and institutional prime and municipal MMFs may charge shareholders liquidity fees, payable to the fund upon redemption, and may impose redemption gates that would temporarily halt all withdrawals.

Retail MMFs are funds that have policies and procedures reasonably designed to limit all beneficial owners to "natural persons" (i.e., individual investors). These funds may continue to seek to maintain a stable NAV, but are subject to potential liquidity fees and redemption gates.

Institutional MMFs are funds that don't qualify as retail funds (i.e., may be held by institutional investors). These funds are subject to potential liquidity fees and redemption gates. They will price and transact at a floating NAV priced out to four decimal places (i.e., $1.0000) and may experience fluctuations from time to time.

Government and U.S. Treasury MMFs are not subject to any of the new structural changes, meaning that these types of MMFs are available to both retail and institutional investors, and are not subject to potential liquidity fees, redemption gates, or a floating NAV.

Fidelity INVESTMENTS

Floating (or Variable) NAV

The daily prices per share of all institutional prime and institutional municipal MMFs are required to "float." This means that instead of fund shares being priced at $1.00, as they were before the new rules, these funds are now required to price and transact at an NAV that uses four-decimal-place precision (e.g., $1.0000), a process known as "basis-point rounding."

When a fund uses basis-point rounding to calculate its NAV, shareholders may experience a gain or loss if the per-share value of the fund changes by 1/100th of a penny. For example, if a shareholder owned 10,000 shares priced at $1.0000, a one basis-point change in a floating-NAV fund would result in a gain or loss of $1.00.

Floating NAV: tax, accounting, and related matters

Shareholders in institutional MMFs may experience gains or losses as the NAV moves up or down. Under existing tax law, any gains or losses could create taxable events. However, under guidance issued by the U.S. Department of the Treasury (Treasury) and the Internal Revenue Service (IRS), floating-NAV shareholders will be able to report a single net total for the gains and/or losses experienced during the course of a year, rather than reporting individual transactions. This will significantly reduce the tax recordkeeping for shareholders.

The Treasury and the IRS have made it clear in their guidance that selling floating-NAV MMFs will not be subject to the wash-sale rule.[1]

With respect to accounting, the SEC stated its position that floating-NAV MMFs will be considered a "cash equivalent."

1 *A wash sale occurs when a security is sold at a loss and within 30 days prior to or after that sale, a "substantially identical" stock or security, or a contract or option is purchased by the same individual, the individual's spouse, or a company controlled by the individual.*

Liquidity Fees and Redemption Gates

The SEC rules permit both retail and institutional prime and municipal MMFs to limit redemptions under certain rare circumstances, by imposing liquidity fees or redemption gates. Subject to the discretion of a MMF's board of trustees, these funds can impose a fee of up to 2% on shareholder redemptions if weekly liquid assets were to fall below 30%. Additionally, a MMF's board may impose a temporary suspension of redemptions if weekly liquid assets were to fall below 30%. This redemption gate can only be in effect for up to 10 business days during any 90-day period.

Summary

At Fidelity, we remain committed to offering a variety of investment options, and a comprehensive MMF product lineup that includes retail and institutional funds, prime and municipal funds, and government and U.S. Treasury funds. As market conditions and investor preferences evolve, we will continue to review our MMF lineup to ensure that we are meeting investors' needs.

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