Money market mutual fund reform 2023

Key Changes

On July 12, 2023, the Securities and Exchange Commission (SEC)—the primary regulator of money market mutual funds ("money market funds") —adopted amendments to Rule 2a-7 and other rules that govern money market funds under the Investment Company Act of 1940 (the "new rules"). The new rules are in response to stresses in fixed income markets at the onset of the COVID-19 pandemic in March 2020. The new rules are being implemented between October 2, 2023, and October 2, 2024.

The new rules are designed to improve the resiliency and transparency of money market funds by

- Removing redemption gate provisions and the link between liquidity thresholds and liquidity fees;
- Allowing non-government money market funds to impose a discretionary liquidity fee if the board determines it to be in the fund's best interests;
- Requiring institutional prime and institutional municipal/tax-exempt money market funds to implement a mandatory liquidity fee under certain conditions;
- Increasing minimum daily and weekly liquidity requirements;
- Allowing stable net asset value (NAV) government and retail funds to use a reverse distribution mechanism (RDM) during a negative interest rate environment to maintain a stable share price;
- Enhancing certain reporting requirements to improve the SEC's ability to monitor and assess money market fund data.

EXHIBIT 1: TYPES OF MONEY MARKET FUNDS

Money market fund type	Net Asset Value (NAV)
Government (including U.S. Treasury)	Stable
Retail Municipal/Tax Exempt[1]	Stable
Retail Prime/General Purpose	Stable
Institutional Municipal/Tax Exempt[2]	Floating
Institutional Prime/General Purpose	Floating

Historical context

The SEC has previously updated the rules governing the management of money market funds to increase transparency and give investors additional protections in times of market stress. In 2010, new rules mandated daily and weekly liquidity levels, more stringent credit quality requirements, shorter portfolio maturities, and stress testing. In 2014, new rules created new definitions for government funds and retail funds, required institutional prime (general purpose) and institutional municipal/ tax-exempt money market funds to price and transact at a "floating" net asset value (NAV), and permitted non-government money market funds to impose liquidity fees and redemption gates in certain conditions.

The SEC originally proposed the current reforms in December 2021 in response to the stresses experienced by money market funds at the onset of the COVID-19 pandemic in March 2020, when institutional prime and institutional municipal/tax-exempt money market funds experienced significant redemptions, which contributed to stress in short-term funding markets.

Summary of new rules

EXHIBIT 2: SUMMARY OF 2023 REFORMS

	Government Money Market Funds	Prime Money Market Funds	Municipal/Tax-Exempt Money Market Funds	Implementation Date
Removal of redemption gates and link between weekly liquid assets and liquidity fees	N/A	●	●	October 2, 2023
Discretionary liquidity fees	N/A	●	●	April 2, 2024
Mandatory liquidity fees	N/A	Institutional Only[2,3]	Institutional Only[2,3]	October 2, 2024
Increased portfolio liquidity requirements	●	●	●	April 2, 2024
Permission to use RDM in negative interest rate environment	●	Retail Only	Retail Only	October 2, 2023
WAM and WAL calculation specification	●	●	●	April 2, 2024
Form N-CR, Form N-MFP, and board reporting enhancements	●	●	●	June 11, 2024

Removal of redemption gates and link between weekly liquidity assets and liquidity fees

Previously, if a non-government money market fund's weekly liquid assets fell below 30%, the fund's board of directors could impose a liquidity fee of up to 2% of shareholder redemptions and/or temporarily suspend redemptions for no longer than 10 days in a 90-day period. If weekly liquid assets fell below 10%, the fund had to impose a liquidity fee of 1%, unless the fund's board determined it was not in the fund's best interest (or that a lower or higher fee [up to 2%] would be in the fund's best interests). These determinations could not be delegated.

In the adopting release for the new rules, the SEC notes that data from March 2020 suggests that: (i) even though no fund imposed a liquidity fee or gate, the possibility of their imposition appeared to contribute to investors' incentives to redeem out of non-government funds; (ii) the 30% weekly liquid asset threshold incentivized funds to keep their weekly liquid assets above 30% rather than use those assets to meet redemptions, and (iii) investors appeared more sensitive to the imposition of a gate than a fee.

Due to these unintended consequences, in the new rules, the SEC removes gates altogether and decouples the liquidity fee from a fund's weekly liquid assets. Instead, the new rules contain a modified liquidity fee framework that will provide for both discretionary and mandatory liquidity fees. A fund's board may delegate determination of discretionary and mandatory liquidity fees to the fund's officers or investment adviser.

Discretionary liquidity fees

The new rules retain discretionary liquidity fees for non-government money market funds, but without the tie to weekly liquid assets. Under the new rules, non-government money market funds are required to impose a discretionary liquidity fee (not to exceed 2% of the value of the shares redeemed) if the fund's board determines that a fee is in the fund's best interests. Government money market funds will not be subject to discretionary liquidity fees, unless they choose to opt in. A discretionary liquidity fee can be applied with or without the mandatory fee.

The new rules do not require a particular approach to determining the level of a discretionary liquidity fee. Once imposed, a discretionary liquidity fee must be applied to all shares redeemed and must remain in effect until the board determines that a fee is not in the best interests of the fund.

Mandatory liquidity fees

The new rules require institutional prime and institutional municipal/tax-exempt money market funds to impose a mandatory liquidity fee if a fund experiences net redemptions that exceed 5% of net assets on a single day (or such smaller amount of net redemptions as the board determines). Once a fund crosses the 5% limit, it must apply the liquidity fee to all shares redeemed at a price computed on that day.

Retail money market funds and government money market funds are not subject to this requirement.

- The mandatory liquidity fee amount must be based on a good faith estimate (supported by data) of the costs the fund would incur if it sold a pro rata amount of each security in its portfolio to satisfy the amount of net redemptions. The calculation must take into account: (i) transaction costs, and (ii) for holdings that are not daily or weekly liquid assets, market impacts. The amount of the fee is not limited.
- No liquidity fee is required if the fund's liquidity costs are de minimis (i.e., less than 0.01% of net assets, or 1 basis point).
- If a fund cannot make a good faith estimate of its liquidity costs, a default mandatory fee of 1% applies.
- Fidelity Investments does not offer institutional prime or municipal/tax-exempt money market funds to the public.

Increased portfolio liquidity requirements

Under the new rules, the SEC increased a money market fund's minimum daily liquid asset requirement from 10% to 25% and minimum weekly liquid asset requirement from 30% to 50%.[4] Consistent with prior rules, if a fund drops below the minimum liquidity thresholds, the fund may not acquire any assets other than daily or weekly liquid assets, respectively, until it meets the thresholds. Municipal/tax-exempt money market funds continue to be exempt from the daily liquid asset minimum requirement.

Liquidity Threshold Event. Under the new rules, if a money market fund holds less than 12.5% of its total assets in daily liquid assets or less than 25% of its total assets in weekly liquid assets (a "liquidity threshold event"), then the fund must notify its board (and publicly report) the liquidity threshold event within one business day of the event, and provide the board with a description of the circumstances leading to the liquidity threshold event within four business days of the event (and amend its public report to include this information).

Amendments to Liquidity Metrics in Stress Testing. In connection with these changes, a money market fund is no longer required to stress test its ability to have at least 10% of its total assets in weekly liquid assets. Instead, the new rules require a money market fund to itself determine the minimum level of liquidity it seeks to maintain during stress periods, periodically stress test its ability to maintain such minimum level of liquidity, and report the findings of the stress tests to the fund's board.

The SEC believes that increased daily and weekly liquidity requirements will provide a more substantial barrier against rapid redemptions during times of market stress, while maintaining the funds' flexibility to invest in diverse assets during normal market conditions. The SEC observed the new thresholds should not have a negative effect on the yield for prime money market funds, as those funds generally have maintained levels of liquidity that are close to, or exceed, the adopted thresholds over the past several years. In the adopting release, the SEC explains that the removal of a bright line threshold for stress testing is designed to increase the utility of stress test results, allowing a fund to determine the level of liquidity it considers sufficient in stress periods, which may differ among funds for a variety of reasons, including fund type and investor characteristics.

Potential Negative Interest Rates and Share Cancellation

In the adopting release, the SEC also addresses the topic of how a government or retail money market fund with a stable net asset value (a "stable NAV fund") may handle a negative interest rate environment, when the gross yield of the fund's portfolio may turn negative, making it difficult for the fund to maintain its stable share price. The SEC notes that in these circumstances, the fund's board may reasonably believe the stable share price does not fairly reflect market price per share and the fund needs to convert to a floating share price as a result. The SEC's original rule proposal would have prohibited a money market fund from reducing the number of its shares outstanding to seek to maintain a stable NAV (referred to as "share cancellation," "reverse distribution mechanism," or "RDM").

In a reversal, the new rules permit a stable NAV fund to utilize RDM[5] to maintain a stable NAV per share in the event of negative interest rates, subject to certain board determinations and prior disclosures to investors, in addition to the fund being permitted to convert to a floating NAV. In another change from the SEC's original proposal, the Final Rule does not require a fund to determine that its financial intermediaries are able to process transactions at a floating NAV. A fund's board cannot delegate the determination to use RDM to the fund's officers or investment adviser.

Calculation of WAM and WAL

The new rules specify that money market funds must use the market value of each security in the fund's portfolio when calculating dollar-weighted average portfolio maturity (WAM) and dollar-weighted average life maturity (WAL) under Rule 2a-7. Some funds currently base calculations on the amortized cost of each portfolio security, and this change is intended to reduce inconsistencies in the data reported to the SEC.

SEC reporting requirements		
Form N-CR	**Form N-MFP**	**Form N-1A**
is amended to add reporting of liquidity threshold events.	is amended to require a large number of new reporting items for money market funds, including additional information about shareholders, portfolio securities sold by institutional prime money market funds, liquidity fees, and use of share cancellation (RDM).	is amended to make certain conforming changes to reflect certain of the other amendments.

Shared goals and communication

Fidelity Investments is well prepared for the new rules and any changes to our product offerings and fund operations needed to comply with them. Throughout the debate on money market fund reform, Fidelity has been engaged with regulators, policymakers, and business leaders, advocating on behalf of our fund shareholders as the discussion developed. Fidelity ultimately shares the same goal as regulators and policymakers: to ensure the strength and stability of money market funds and our financial system while preserving the benefits that these funds provide investors, issuers, and our economy.

Money market funds are an integral part of Fidelity's business. We continue to be vigilant in keeping our money market funds safe and liquid, including protecting the $1.00 NAV, which has always been our number-one objective in managing these funds. Fidelity will continue to communicate with our customers, keeping them well informed by providing information, updates, and perspective.

For more information about the SEC's final rules, please read Fidelity's publication, "Understanding Liquidity in Money Market Mutual Funds."

You could lose money by investing in a money market fund. An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Before investing, always read a money market fund's prospectus for policies specific to that fund.

These materials are provided for informational purposes only and should not be construed as a recommendation of any security, sector, or investment strategy. Please consult your tax or financial advisor for additional information concerning your specific situation.

Before investing, consider the funds' investment objectives, risks, charges, and expenses. Contact Fidelity for a prospectus or, if available, a summary prospectus containing this information. Read it carefully.

An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund.

Views expressed are as of the date indicated, based on the information available at that time, and may change based on market and other conditions. Unless otherwise noted, the opinions provided are those of the authors and not necessarily those of Fidelity Investments or its affiliates. Fidelity does not assume any duty to update any of the information.

Investment decisions should be based on an individual's own goals, time horizon, and tolerance for risk.

Past performance is no guarantee of future results.

[1]Retail funds limit shareholders to beneficial ownership by "natural persons" (individuals).

[2]Institutional funds are open to any shareholders, including individuals, small businesses, and large corporations.

[3]Includes institutional money market funds whose shares are not offered publicly by Fidelity Investments.

[4]Assets that make up daily liquid assets and weekly liquid assets are cash or securities that can readily be converted to cash within one business day or five business days, respectively.

[5]Investors in a fund that uses such a share cancellation mechanism would experience a stable share price but a reduced number of shares for their investment, and thus an overall reduction in their account values.

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