Reliance Trust Insights

Critical Information for Retirement Plan Fiduciaries

ISSUE 2 JUNE 2015

Reliance Trust
An FIS Company

Retirement Strategies Team

If you have any questions about our ERISA fiduciary services, please contact your account representative or any member of our team below.

Larry H. Goldbrum, *Esq., SVP & Director of ERISA Fiduciary Services*
404-965-7248
larry.goldbrum@fisglobal.com

Kent Buckles, *EVP, Retirement Strategies Group*
kent.buckles@fisglobal.com
Sales Region—West

Martin Campbell
marty.campbell@fisglobal.com
Sales Region—Midwest

Trey Carter
trey.carter@fisglobal.com

Sharon Ennis
sharon.ennis@fisglobal.com

Robert Lee
bob.lee@fisglobal.com
Sales Region—Mid-Atlantic

Michael Spencer
michael.spencer@fisglobal.com

E. Hunter Ward
hunter.ward@fisglobal.com
Sales Region—Northeast (including New York)

Money Market Funds Changes - Implications for Plan Sponsors, Plan Administrators and Investment Fiduciaries

> "Money market funds will generally be subject to daily pricing requirements, i.e., float their NAV and price daily to four decimal places, instead of using a stable $1.00 NAV."

New SEC money market funds rules that go into effect in 2016 will impact nearly every retirement plan that uses such funds as investment options or to facilitate plan administration.[1] The new rules change how money market funds will be invested, priced, operated and act when financial markets are under stress. Plan sponsors, investment committees, those who advise them ("investment fiduciaries") and plan administrators should understand the upcoming changes in order to determine what steps, if any, that will be required or may be beneficial to take regarding such funds, and to consider their alternatives.

[1]Stable NAV money market funds are often used as a liquidity buffer in retirement plan separate accounts and plan specific funds (e.g., employer stock funds) for cash sweep purposes, and to handle the daily cash needs resulting from plan participant redemptions.

The impending changes are the second set of rules adopted by the SEC in response to the financial crisis of 2008, when the Reserve Primary Fund "broke the buck" requiring the U.S. Treasury to guarantee shareholders' investments. This most recent set of rules are intended to limit the first mover advantage and control redemptions in times of market stress, and increase fund transparency. The SEC adopted three critical tools in order to accomplish its goals:

1. **Floating NAV** - Money market funds will generally be subject to daily pricing requirements, i.e., float their NAV and price daily to four decimal places, instead of using a stable $1.00 NAV.
2. **Redemption Fees** - Money market funds will generally be permitted, and in some instances required, to impose redemption fees on all investors when a fund's liquidity falls below certain levels. The voluntary and mandatory redemption fees can be as much as two percent and one percent, respectively, and can be imposed on the same day the low liquidity trigger is met.
3. **Redemption Gates** - Money market funds will also generally be permitted to suspend redemptions ("gate" the fund) for up to 10 business days when a fund's liquidity falls below a certain level. The gate can be imposed on the same business day that the low liquidity trigger is met and must apply to all investors; there is no exemption for retirement plan transactions.

Special Rules for "Government" and "Retail Funds"

Recognizing that certain underlying investments of money market funds and certain money market fund investors respond differently and pose different risks in times of market stress, the SEC defined two categories of such funds and restricted what they can invest in and who can invest in them as follows:

> "Government funds will be exempt from the floating NAV requirements, and will not be required, but will be permitted to impose the redemption fees and gates. "

Government Funds - These will have a policy to invest at least 99.5% (up from 80%) of their assets in cash, government securities, or repurchase agreements collateralized solely by government securities or cash. These include treasury money market funds that limit their holding generally to 99.5 % in U.S. Treasury securities. Government funds will be exempt from the floating NAV requirements, and will not be required, but will be permitted to impose the redemption fees and gates.

Retail Funds - This newly defined category of funds must limit ownership to natural persons, and cannot be held by institutional investors. Simply stated, natural persons would include individuals who invest through participant directed defined contribution ("DC") plans, but would not include defined benefit plans.[2] Existing money market funds with institutional and retail share classes will have to be reorganized into separate funds in order to comply with the new rules. However, retail funds are exempt from the floating NAV rules but remain subject to the redemption fees and gates requirements.

> "...retail funds are exempt from the floating NAV rules but remain subject to the redemption fees and gates requirements. "

The new requirements are summarized in the chart below.

[2] A footnote in the preamble to the SEC rules states that natural persons invest through "(i) participant directed defined contribution plans (section 3(34) of the Employee Retirement Income Security Act (''ERISA'')); (ii) individual retirement accounts (section 408 or 408A of the Internal Revenue Code (''IRC'')); (iii) simplified employee pension arrangements (section 408(k) of the IRC); (iv) simple retirement accounts (section 408(p) of the IRC); (v) custodial accounts (section 403(b)(7) of the IRC); (vi) deferred compensation plans for government or tax-exempt organization employees (section 457 of the IRC); (vii) Keogh plans (section 401(a) of the IRC)…. Accounts that are not beneficially owned by natural persons (for example, accounts not associated with social security numbers), such as…defined benefit plans,… would not qualify as retail money market funds." 79 Fed. Reg. 47,798, fn. 697 (August 14, 2014).

Important Considerations for Plan Sponsors, Plan Administrators and Investment Fiduciaries

New Money Market Funds Rules Summary

Fund Types	Net Asset Value (NAV)	Liquidity Fee	Redemption Gate	Investments
Treasury	Stable	No	No	Funds that have a policy to invest at least 99.5% of assets in U.S. Treasury securities and repurchase agreements collateralized by U.S. Treasury securities.
Government	Stable	No	No	Funds that have a policy to invest at least 99.5% of assets in the those identified above and other government securities.
Retail Prime	Stable	Yes	Yes	Any eligible money market instrument as defined by SEC Rule 2a-7, including those listed above, and commercial paper, certificates of deposit, corporate notes, and other debt instruments.
Institutional Prime	Floating, computed to four decimals	Yes	Yes	Same as Retail Prime.

Plan sponsors, plan administrators and investment fiduciaries should become educated about the potential implications for their plans and consider the following in connection with the changes:

Fund Currently Used - Determine the type of money market fund being used and for what purposes. For example, (1) is the fund an investment option for participants, (2) is it used for plan administration, (3) is it used in connection with forfeiture and suspense accounts (e.g., revenue sharing payments), and (4) is a single fund used for multiple plan purposes? With that information, investment fiduciaries can begin to understand the potential implications for their plans and whether changes may be necessary or beneficial.

Fund Manager's Intentions - Another critical part of the review process is understanding the fund manager's intentions regarding a fund that the plan is using, including (1) whether existing government funds will increase their holdings of government securities in order to continue to be categorized as such, (2) whether government funds will reserve the right to impose redemption fees and gates, (3) whether existing prime funds that permit retail and institutional investors will be divided into two separate funds or closed for one of the groups, and (4) whether fund managers will make retail prime money market fund shares available to retirement plan investors? These are just some of the fund company decisions that will impact the options available to a plan and the decisions that investment fiduciaries are likely to have to make.

"Investment fiduciaries may want to use this event to evaluate the capital preservation investment alternative in their fund lineup and consider other options that may be available."

Plan Record Keeper's Intentions - In the retirement plan world, investment funds will generally be dependent on plan record keepers to impose redemption fees and gates on behalf of the funds. Some plan record keepers, particularly those who do not also manage money market funds, may be reluctant to make the necessary system and process changes. Consequently, some funds may not be available on some record keeping platforms. Investment fiduciaries should contact their record keepers and determine how their intentions will impact the future use of the different types of money market funds.

Investment Considerations - The new regulatory structure was intended to preserve choices among money market funds for investors to be able to select one that has the characteristics that meets their preferences among principal stability, liquidity and yield. Another characteristic plan sponsors may want to consider is simplicity. As a plan investment option, government funds may provide stability, liquidity and simplicity but require a trade-off in yield. Retail prime funds may provide a slightly higher yield in the current interest rate environment but they involve some liquidity risk and are more complex. As explained below, plan administrators will have to provide participant disclosures about these impending changes. Investment fiduciaries may want to use this event to evaluate the capital preservation investment alternative in their fund lineup and consider other options that may be available (e.g., stable value funds, bank deposit vehicles, among others).

> "...mutual fund companies and record keepers are making decisions now that responsible plan sponsors, plan administrators and investment fiduciaries should begin to investigate and consider their options."

Plan Participant Implications - Investment fiduciaries and plan administrators will also want to consider the potential implications for plan participants. Changes to a fund line-up, important changes in how a fund invests, how it is priced and the potential for redemption fees and gates are matters that will have to be communicated to participants. This may require explanations about the impact on potential returns of certain funds that will have to invest more conservatively than before in order to meet the definition of government funds and to maintain sufficient liquidity to avoid crossing the low liquidity triggers for fees and gates. Plan sponsors, plan administrators and investment fiduciaries may also want to consider (1) the uncertainty and unpredictability of the timing surrounding fees and gates—when triggered, they would be imposed on participants, and could have to be communicated, on very short notice (i.e., less than one day), (2) the potential additional administrative complexity[3] in the rare event that fees or gates are imposed, and (3) the potential participant dissatisfaction under such circumstances.

[3]Fees and gates are also likely to add complexity in connection with plan administration, including processing participant-initiated distributions, and other distributions required under the Internal Revenue Code. For example, plans are required to distribute amounts that exceed certain limits by a specific date every year. Additionally, participants who are age 70-1/2 and no longer employed generally must receive distributions by a certain date every year. A redemption gate could prevent a plan sponsor from making a required distribution in a timely manner and subject such plan sponsor and the participants to penalties. Additionally, a redemption fee would impose a financial burden on individuals who are required to receive such distributions.

Implementation Date

The new rules must be implemented by mutual fund companies by **October 14, 2016**. While that may seem like the distant future, mutual fund companies and record keepers are making decisions now that responsible plan sponsors, plan administrators and investment fiduciaries should begin to investigate and consider their options. If you have any questions about this information please contact us.

> "...mutual fund companies and record keepers are making decisions now that responsible plan sponsors, plan administrators and investment fiduciaries should begin to investigate and consider their options."

About Reliance Trust

Reliance Trust is one of the largest and fastest growing trust companies that serves as an independent fiduciary to the retirement and benefit plans industries in the United States. Its retirement strategies group provides retirement trust services that include ERISA fiduciary services, institutional plan services and collective investment funds. Reliance Trust provides ERISA fiduciary services as a discretionary trustee, directed trustee, independent fiduciary, and an ERISA 3(38) investment manager.

Author's Biography

Larry Goldbrum, Esq., SVP and director of the Reliance Trust ERISA fiduciary services team. He also provides thought leadership on critical retirement plan industry issues with more than 30 years of legal experience in the retirement and investment services industries.

Larry previously served as general counsel of The SPARK Institute, Inc., and as chairman of SPARK's Government Relations Committee for nine years, where he provided significant industry leadership on critical retirement plan issues, including fiduciary and fee disclosure matters. Larry has also been recognized five times by 401(k) Wire as one of the *100 Most Influential People in Defined Contribution*.