Retirement Guidance

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LOCKTON RETIREMENT SERVICES

MONEY MARKET REFORMS ARE COMING: IS YOUR PLAN READY?

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Following the financial crisis of 2008, when heavy redemptions broke the buck in money market funds (MMFs), the Securities and Exchange Commission (SEC) is planning changes for how those funds operate. The new rules will impact more than $375 billion of retirement assets, or nearly 64 percent of all defined contribution plans in America.

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Two Significant Reforms

Floating the NAV

Prime institutional MMFs must float their Net Asset Value (NAV), meaning prices would fluctuate daily rather than maintaining a stable $1.00 per share price.

Allowing price fluctuations eliminates the current incentive to redeem shares in times of fund and market strain, causing stress to the funds as well as other shareholders. It also improves the transparency of the funds' investment risks through more accurate valuation and pricing methods.

The floating NAV rule excludes government and retail MMFs, which can still offer a stable NAV. Retail money market funds, however, are only available to natural persons, meaning anyone with voting and investment power. Thus, only participant-directed defined contribution (DC) plans, not defined benefit (DB) plans, would be eligible for retail MMFs.

Liquidity Fees and Gates

The second reform includes both prime institutional and retail MMFs, but not government MMFs. It allows a stable share price but imposes fees and redemption gates during times of market stress. Each fund's board of directors would decide when to impose restrictions. The rule allows for a 2 percent redemption fee if the MMF's weekly liquid assets fall below 15 percent. If a MMF crosses a liquidity threshold, its board of directors may also impose a temporary halt on redemptions. The redemption gates can last no longer than 10 days and cannot be imposed more than once in a 90-day period. Although liquidity fees and gates will likely trigger only in extreme market stress, these requirements may drive investors to government funds which do not have to comply.

Retirement Plan Impact

- DB plans commonly use MMFs to maintain proper levels of liquidity, enabling benefit payments. Liquidity gates could impair the plan's ability to make these payments and should be of special concern to plans with higher liquidity needs (i.e., plans that pay lump sums). If MMFs become less attractive due to these new rules, DB plans may have to use other short-term investment vehicles, potentially increasing financial volatility and plan expenses.
- Many DC plans hold forfeiture accounts (generated when participants terminate before becoming fully vested) in MMFs. Sponsors must use forfeitures for expenses incurred within the year they are generated or allocate them to participants. Gates may suspend the plan's access to these assets and prevent timely use.
- MMFs are common in retirement plans and especially popular with participants nearing retirement and becoming more conservative. The new rules may make them less attractive by removing the benefits they are known for today: stability, liquidity, and zero redemption fees.
- Liquidity fees or redemption gates may pose problems in the 90-day period following a participant's default investment into a MMF intended for QDIA relief. When restrictions are in force, if defaulted participants want their money returned, the SEC's solution would require a plan sponsor to pay the participant fee directly or through a loan from an interested party.
- Paying out required minimum distributions and distributing refunds on a timely basis could also be a problem. The SEC stated that, to the extent a redemption fee prevented timely RMD payment, individuals could file a request with the IRS for an excise tax waiver.

Next Steps

Plan sponsors must consider liquidity and potential redemption restrictions when evaluating a MMF for a plan's investment lineup. For DB plan sponsors, this is particularly important as prime MMFs will have more volatility and less liquidity than government securities. Plan fiduciaries should review their investment strategy and policies to determine whether prime MMFs continue to be prudent options. Although, because the retail exception generally exempts DC plans, some more expensive MMFs may still have a fixed $1 per share value. The reforms take effect on October 14, 2016, and, while the MMF managers have been preparing for some time, sponsors should contemplate the impact and potential plan changes now.

		Investor Types			
		Institutional		Retail	
		Fund Types			
		Prime	Government	Prime	Government
CURRENT	NAV	Fixed	Fixed	Fixed	Fixed
	Redemption Gates	No	No	No	No
	Liquidity Fees	Daily	Daily	Daily	Daily
FUTURE	NAV	Floating	Fixed	Fixed	Fixed
	Redemption Gates	Up to 2%	No	Up to 2%	No
	Liquidity Fees	Daily—with exceptions	No	Daily—with exceptions	No

If you have questions, please contact your Lockton Retirement Services team.

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