Invesco

Money Market Regulatory Reform

Aug.15, 2014

Diving into Money Market Reform

Summary of conference call held on July 28, 2014

Background

- On July 23, 2014, the Securities and Exchange Commission (SEC) voted to approve new rules and amendments to Rule 2a-7 under the Investment Company Act of 1940, which governs US money market funds.
- These amendments were approved by three out of the five SEC Commissioners and come as the final step following their proposed rule release last summer (June 2013).
- The SEC stated that the purpose of these rules will include structural and operational reforms to address risks of investor runs in money market funds, while preserving the benefits of the funds.

Crucial points for money market fund investors to understand

There will be no immediate changes to money market funds. The SEC has provided a very extensive implementation schedule, which extends up to two years, depending on the specific rule. This gives investors a significant period of time to analyze the impact of the rules and to make well informed decisions for your cash needs.

From an investment standpoint, these rules do not change how Invesco manages money market funds. Safety, liquidity and then a competitive yield as a byproduct of our process is how we have managed money market funds for the past 30 years and will continue to operate under this philosophy in the future.

Invesco is well prepared to handle these changes. At Invesco we have spent the past several years preparing for the possibility of rule changes and we are dedicated to helping you, our clients, understand the implications of these new rules. We are committed to working with you to understand and implement these rules.

What is not changing?

Government and retail money market funds

- **Stable net asset value (NAV) for government and retail money market funds:** Government and retail money market funds would be allowed to continue using the amortized cost method and/or penny rounding method[1] of pricing to seek to maintain a stable share price.

  The SEC has provided two key definitions:

  - **Retail money market fund:** A retail money market fund would be defined as a money market fund that has policies and procedures reasonably designed to limit all beneficial owners of the money market fund to natural persons.[2]
  - **Government money market fund:** A government fund would be defined as a money market fund that invests at least 99.5% of its total assets in cash, government securities, and/or repurchase agreements that are "collateralized fully" (i.e., collateralized by cash or government securities).

What is changing?

Institutional prime and municipal money market funds

- **Floating NAV:** Institutional prime and municipal money market funds will have a floating net asset value (FNAV) for 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). The requirement would result in the daily share prices of these money market funds fluctuating along with changes in the market-based value of the funds' investments.
  - **A municipal (or tax-exempt) fund** would be required to transact at a FNAV unless the fund meets the definition of a retail money market fund, in which case it would be allowed to use the amortized cost method and/or penny rounding method of pricing to seek to maintain a stable share price.
- **Liquidity fees (optional until the fund's weekly liquid assets fall below 10%):** Under the rules, if a money market fund's level of "weekly liquid assets" falls below 30% of its total assets (the regulatory minimum), the money market fund's board would be allowed to impose new tools – fees and gates.
  - **If "weekly liquid assets" falls below 30%:** Money market funds would be allowed to impose a liquidity fee of up to 2% on all redemptions. Such a fee could be imposed only if the money market fund's board of directors determines that such a fee is in the best interests of the fund.
  - **If "weekly liquid assets" falls below 10%:** Money market funds would be required to impose a liquidity fee of 1% on all redemptions. However, such a fee would not be imposed if the fund's board of directors determines that such a fee is not in the best interests of the fund or that a lower or higher (up to 2%) liquidity fee is in the best interests of the fund.
- **Gates (always optional)**
  - **If "weekly liquid assets" falls below 30%:** Money market funds could temporarily suspend redemptions ("gate"). To impose a gate, the Fund's board of directors would find that imposing a gate is in the money market fund's best interests. A money market fund that imposes a gate would be required to lift that gate within 10 business days, although the board of directors could determine to lift the gate earlier. Money market funds would not be able to impose a gate for more than 10 business days in any 90-day period.

Importantly, the Fund's Board maintains discretion over what is in the best interest of shareholders, so the fees and gates are really additional tools the Board has to help protect investors in times of stress.

Tax, accounting, and credit issues addressed by these reforms

- **Cash equivalent status:** The SEC clarified that stable NAV investments will continue to be classified as cash equivalents, and the FNAV investments will also be classified as cash equivalents.
- **Tax treatments for gains and losses:** The IRS is proposing a simplified aggregate method which will allow money market fund investors to compute net capital gains or losses for a year by netting their annual redemptions and purchases with their annual starting and ending balances. This would enable investors to determine their annual net tax gains or losses using information currently provided on shareholder statements and will eliminate any requirement to track each individual share purchase, redemption and the basis of each share redeemed.
  - **Wash Sales:** Under the simplified aggregate method of accounting, tax payers will compute aggregate gains or losses for a period, and gains or losses will not be associated with any particular sale of shares, thus the wash sale will not affect any shareholder that chooses to use the simplified aggregate method of accounting for gains and losses.
- **Removal of credit ratings references:** Currently, section 939A of the Dodd Frank Act requires the SEC to remove any reference to, or requirement of, reliance on credit ratings in its regulations, and to establish appropriate standards of creditworthiness in place of certain references to credit ratings.

  As part of these reforms, the commission re-proposed that an eligible security be a security with a remaining maturity of 397 days or less, which the fund's board of directors has determined presents minimal credit risks, i.e. the issuer has an exceptionally strong capacity to meet its short term obligations. As a result, there would be a single standard and elimination of the distinction between first and second tier securities.[3] Additionally, they are re-proposing the removal of the current prohibition on funds investing more than 3% their portfolios in second tier securities.

Proposed implementation timeline for these reforms

The reforms will become effective 60 days after their publication in the Federal Register, although the compliance dates for these are substantially farther in the future:

- **Structural e-forms**
  - **FNAV, fees, gates:** These structural changes will have a 2 year implementation period.
- **Operational Reforms**
  - **Form NCR:** This captures what the SEC calls "material event disclosure", and has a nine month implementation period. This is a new form designed to document instances where an NAV would fall between a certain level and when fees and gates where implemented.
  - **Diversification, stress testing and disclosure:** Reforms that address diversification, stress testing and disclosure would have an 18 month implementation period.

Q&A Summary

Do we foresee any changes to the management style and strategy of Invesco's money market funds?

We don't see any changes to our philosophy, style or investment process. Our funds are managed to safety, liquidity and yield, and we're going to continue to manage in the same way. We've already been adhering to the weekly liquidity requirements and monitor the mark-to-market on a daily basis. We also employ stress testing to help ensure we maintain appropriate levels of liquidity. All these activities are centered on the fundamental principles of safety, liquidity and yield, and that will continue.

Will there be any impact to Invesco's money market funds given the removal of the credit rating requirement?

No impact is expected. We've always had a dedicated, experienced team of fixed income research analysts performing their own independent research for our funds. This team will continue to support our money market funds in the same way they have in the past.

Can you help us understand the "retail" definition that the SEC provided?

Under these reforms, retail money market funds can continue offering shares at a stable NAV. This includes prime and municipal money market funds that are available only to retail investors. Retail money market funds will have policies and procedures in place to limit all beneficial owners of retail funds to natural persons. In the case of omnibus accounts that own shares of retail money market funds, the money market fund will work with intermediaries to determine that the underlying beneficial owners of the omnibus account are natural persons.

Explore Intentional Investing with Invesco®

1 Amortized Cost Method/Penny Rounding Method: Pursuant to SEC Rule 2a-7, the Funds use the amortized cost method of accounting, rounded to the nearest cent, to value their securities when calculating their net asset value for purposes of all Portfolio share transactions.
2 Rule 2a-7 of the Investment Company Act of 1940, which governs money market funds, will be amended to define a "retail money market fund" as a money market fund that has policies and procedures reasonably designed to limit all beneficial owners of the fund to natural persons. In its release accompanying the final rules, the SEC states that money market funds will have flexibility in how they choose to comply with the natural person test, including developing policies and procedures that best suit a fund's investor base. The SEC expects that many funds will rely on social security numbers to confirm beneficial ownership by a natural person; however a money market fund or the appropriate intermediary could determine the beneficial ownership of a non-US natural person by obtaining other government-issued identification, for example, a passport. Retail money market funds will also develop policies and procedures in order to determine that underlying beneficial owners of omnibus accounts are natural persons.
3 **First Tier:** An eligible money market security which receives the top short-term rating from any two Nationally Recognized Statistical Rating Organizations (NRSROs). If only one NRSRO has rated the security, it must receive the highest short-term rating from that NRSRO to be considered First Tier. US Government Securities are considered First Tier Securities.
Second Tier: An eligible money market security which is not a First Tier security and receives one of the top two short-term ratings from any two NRSROs. If only one NRSRO has rated the security, it must receive the second highest short-term rating from that NRSRO to be considered Second Tier.

NRSROs = Nationally Recognized Statistical Rating Organizations

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An investor should consider the investment objectives, risks, fees and expenses carefully before investing. Please read the prospectus or other offering documents carefully before investing. For this and other important information, please contact your financial advisor or visit invesco.com/fundprospectus.

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

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