Goldman Sachs | Asset Management

2023 MMF Reform Overview

LIQUIDITY SOLUTIONS

CLIENT PORTFOLIO MANAGEMENT AND PRODUCT STRATEGY

JULY 24, 2023

Executive Summary and Key Takeaways

On July 12th, 2023, the Securities and Exchange Commission (SEC) voted 3/2 to adopt amendments to certain rules that govern money market funds (MMFs) under the Investment Company Act of 1940

QUICK FACTS OF THE NEW RULE

- Swing pricing was NOT adopted. The SEC removed existing provisions which permit temporary gates and/or redemption fees for retail and institutional prime and tax-exempt (TE) funds when minimum liquidity limits are breached. Instead, the SEC implemented a **mandatory liquidity fee** based on fund flows for **institutional prime and institutional TE funds**
- Higher daily and weekly liquid asset levels were adopted as initially proposed
- The SEC also specified certain calculations for weighted average maturity (WAM) and weighted average life (WAL) along with adjusting certain reporting requirements for fund managers
- The rule also allows stable NAV money funds to handle a negative interest rate environment either by converting to a floating share price or by reducing the number of shares outstanding to maintain a stable NAV

OUR INITIAL HIGH-LEVEL TAKEAWAYS

- While initially viewed from the industry collectively as “better than expected” or “at least it is not swing pricing” we believe the implications are larger than currently priced among participants
- Institutional prime funds will likely bear the brunt of the new regulations and could continue to stimulate the migration from prime to government funds
- Higher required liquidity levels in the long term will drive the yields for prime and government MMFs closer together
- From a timing perspective, the amendments will become effective 60 days after publication of the amendments in the Federal Register. The implementation deadlines are tiered with the mandatory liquidity fee likely becoming effective in the 4th quarter of 2024
- Retail MMFs are primed for a greater investor base and resulting inflows from the removal of gates and fees from the product set

Source: Goldman Sachs Asset Management, SEC (Full Rule linked here)

4 Rule Changes To Highlight In The Updated U.S. MMF Regulatory Framework

1) MANDATORY LIQUIDITY FEE

Summary: The new rule requires institutional prime & institutional TE funds to impose a liquidity fee when daily net outflows from the fund exceed 5% of net assets, unless the fund's liquidity costs are de minimis (i.e. less than 0.01%). The liquidity fee itself is calculated by using a good faith estimate of liquidity costs for the fund to sell a vertical slice of the portfolio to meet the net redemptions. If the fund cannot estimate the liquidity costs, a default liquidity fee of 1% will be used. The timeline for funds to comply is 12 months from the effective date.

Our Takeaway: While an operational improvement over the initially proposed swing pricing, the new mandatory liquidity fee will likely be the most impactful ruling to the industry and may spur institutional prime outflows.

2) STABLE MMF OPTIONS IN A NEGATIVE RATE ENVIRONMENT

Summary: Government and Retail MMFs have two specified mechanisms to deal with a negative interest rate environment: 1) converting from a stable share price to a floating share price or 2) reducing the number of shares outstanding to maintain a stable net asset value per share (reverse distribution mechanism, RDM).

Our Takeaway: A floating NAV for a government MMF is a non-starter for most investors, but our view is that a negative rate landscape is a low probability given the unwillingness of the Fed to do so in prior stressed periods (e.g. March 2020, 2008, etc.). Despite these low odds, the inclusion of RDM (which was prohibited in the initial proposal) will likely be welcomed by the industry to avoid the significant costs to both investors and providers in converting a government fund to a floating NAV.

3) REMOVING THE LINK B/W WLA AND GATES/FEES

Summary: Currently, all prime & tax-exempt (TE) funds may impose a liquidity fee or redemption gate if weekly liquid assets (WLA) drop below 30% and are required to impose a fee if WLA drop below 10%. This rule removes the ability of temporary redemption gates and the tie between the WLA and liquidity fees.

Our Takeaway: Overall, we believe this is a net positive for the industry and investors. The removal should enhance the attractiveness of the retail MMFs effected and may stimulate inflows into that segment from previously sidelined investors.

4) AN INCREASE IN REQUIRED LEVELS OF DAILY & WEEKLY LIQUIDITY

Summary: Requires MMFs to increase their daily liquid assets (DLA) from 10% to 25% and weekly liquid assets (WLA) from 30% to 50%. This rules impacts all MMFs. The timeline for implementation is 6 months from the effective date. However, many funds are operating under these metrics currently given the economic picture.

Our Takeaway: This is a sizeable increase. That said, we expect a fairly muted response in terms of a negative yield impact in the status quo based on current positioning. It will likely serve as a larger force in the future.

Source: Goldman Sachs Asset Management. Full Rule linked here

Potential Impact from Change 1: Mandatory Liquidity Fee

	Initially Proposed: Swing Pricing	Final Rule: Mandatory Liquidity Fee
Description of the mechanism	The fund's NAV is adjusted downward by a swing factor when the fund has net redemptions in excess of 4% only to redeeming investors	A mandatory fee is charged to redeeming investors when the fund has net redemptions above 5% of net assets, unless fund liquidity cost is "de minimis"
Funds under scope of the Rule	Institutional prime and institutional tax-exempt money market funds	Institutional prime and institutional tax-exempt money market funds
Size and calculation of the charge/fee	The swing factor applied to the NAV would be determined by making good faith estimate if the fund were to sell a pro rata amount of each security in its portfolio to satisfy the net redemptions	The liquidity fee charged would be determined by making good faith estimate if the fund were to sell a pro rata amount of each security in its portfolio to satisfy the net redemptions If the estimated liquidity costs are less than 0.01% of value for shares redeemed, a fee is not required - de minimis exception If the fund cannot estimate the liquidity costs in good faith and supported by data, a default liquidity fee of 1% is used

- Perhaps the most impactful amendment is the mandatory liquidity fee, which adds many additional layers of complexity to institutional prime funds for both fund managers and investors alike
- The activation method for a fee is based on investor behavior rather than direct market pricing or events which could result in false triggering (e.g., a single investor redeeming a large block for day-to-day use or an expected capital event)
- In our analysis, all active institutional prime funds have had a 5% net redemption day over the last 4 years with over 500 total triggered days - implying that mandatory liquidity fees will be needed in the industry at some point
- We estimate that this new rule could stimulate outflows from institutional investors who have remained thus far in prime funds

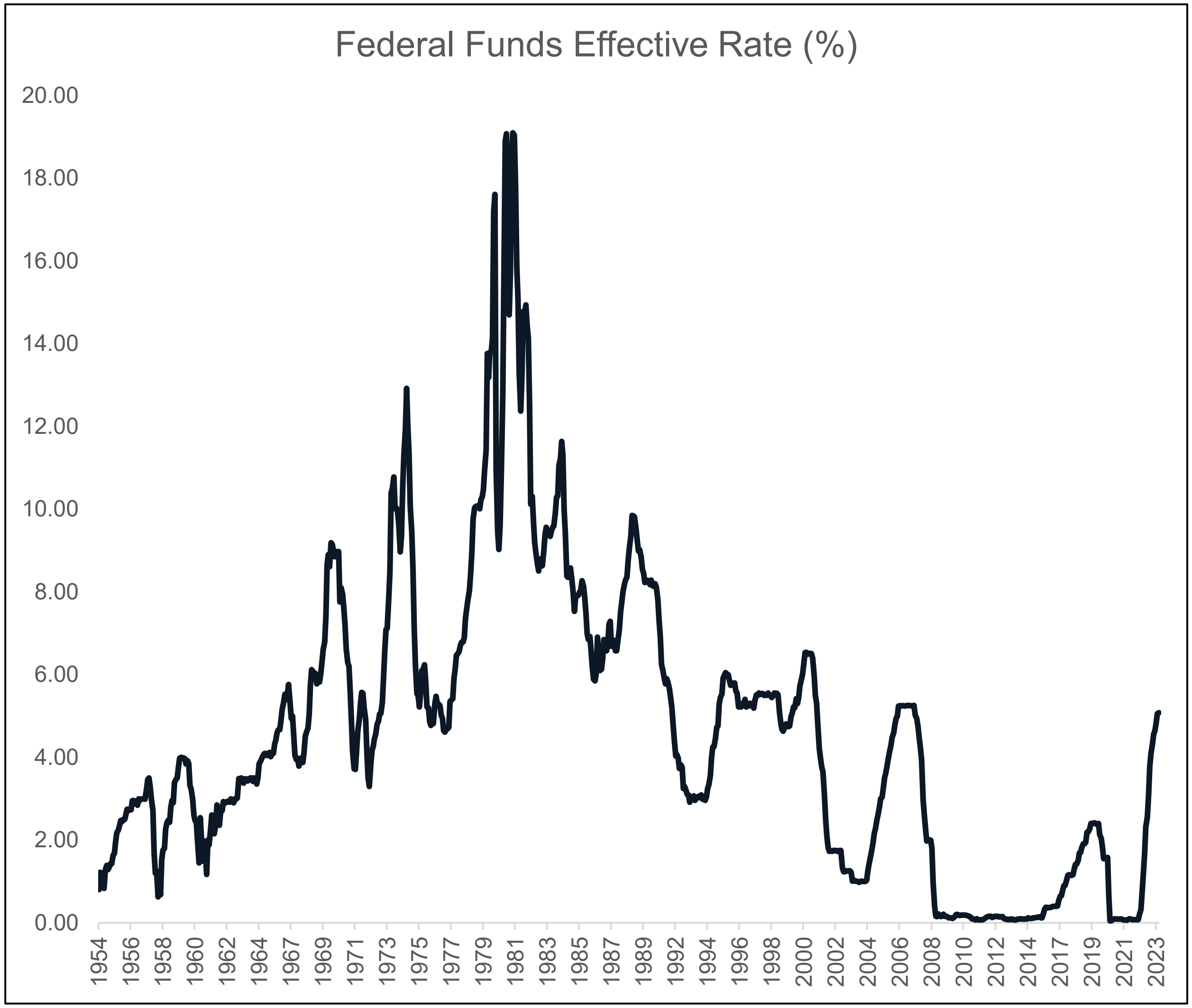
Source: Goldman Sachs Asset Management. Analysis data sourced from iMoneyNet as of July 12, 2023. For illustrative purposes only.

Potential Impact from Change 2: Optionality for Stable MMFs in a Negative Rate Environment

- The rule specifies the actions a stable NAV fund must take during a negative rate environment - convert from a stable to a floating NAV or reduce the number of shares outstanding to maintain a stable NAV (a.k.a. RDM or reverse distribution mechanism)

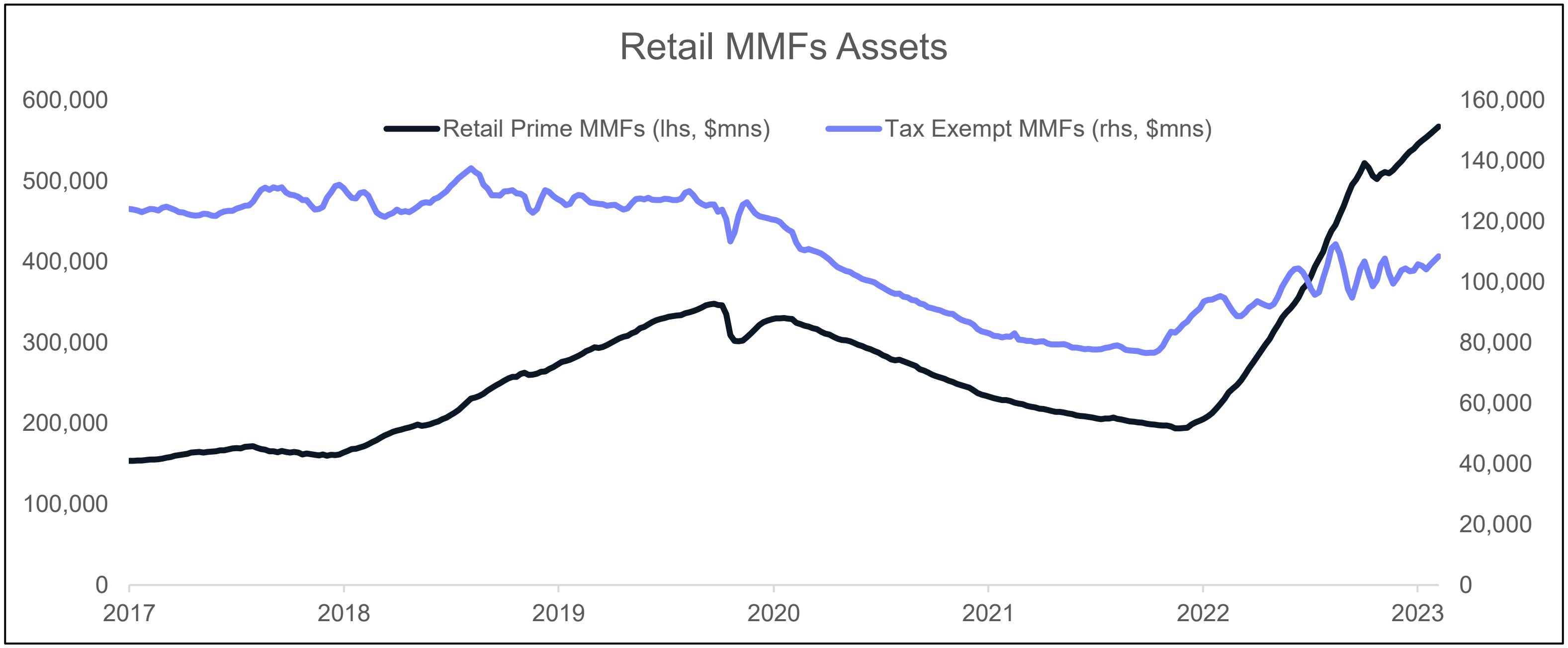
- While outlined in this rule, we believe the possibility of the Fed taking rates negative is low as evidenced in the historical refusal even in periods of considerable stress

- Global money fund managers have had significant experience operating in a negative rate environment with RDM in the Euro-denominated MMF market



Source: Bloomberg, Goldman Sachs Asset Management. Data as of June 2023. For illustrative purposes only.

Potential Impacts from Change 3: Removing Gates and the Link Between WLA and Fees



- Our view is the retail specific money funds (MMFs that are generally limited to natural persons) are geared up for potentially significant inflows as a result of the removal of redemption gates and liquidity fees from these funds

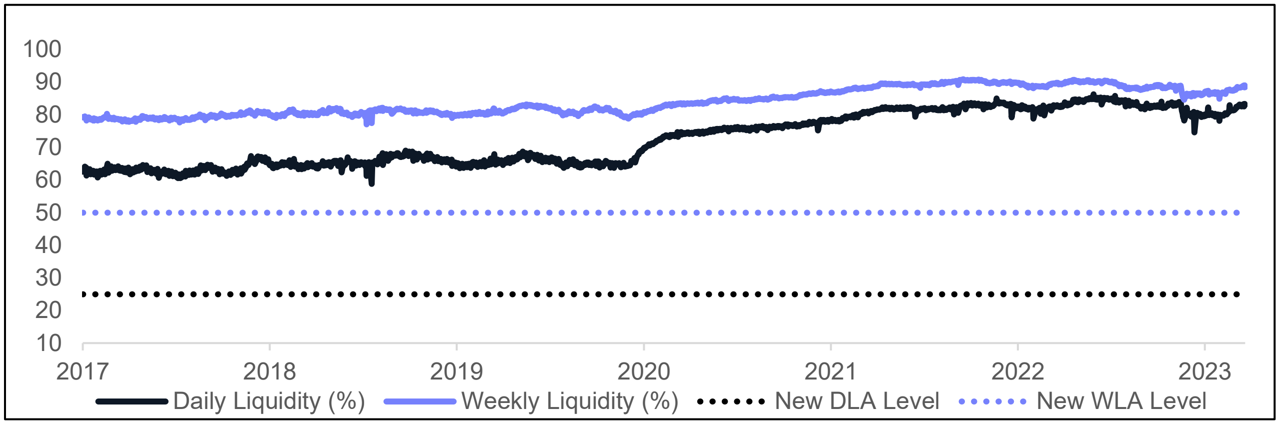
- Many wealth platforms after the 2014 reforms became weary of the possibility of their cash being gated or subject to liquidity fees in times of stress (which are also typically times of cash needs)

- Thus, we anticipate increased interest in retail prime and retail tax-exempt money market funds which will likely emerge as in-flows into the space

Source: iMoneyNet, Goldman Sachs Asset Management. Data as of July 11, 2023. For illustrative purposes only.

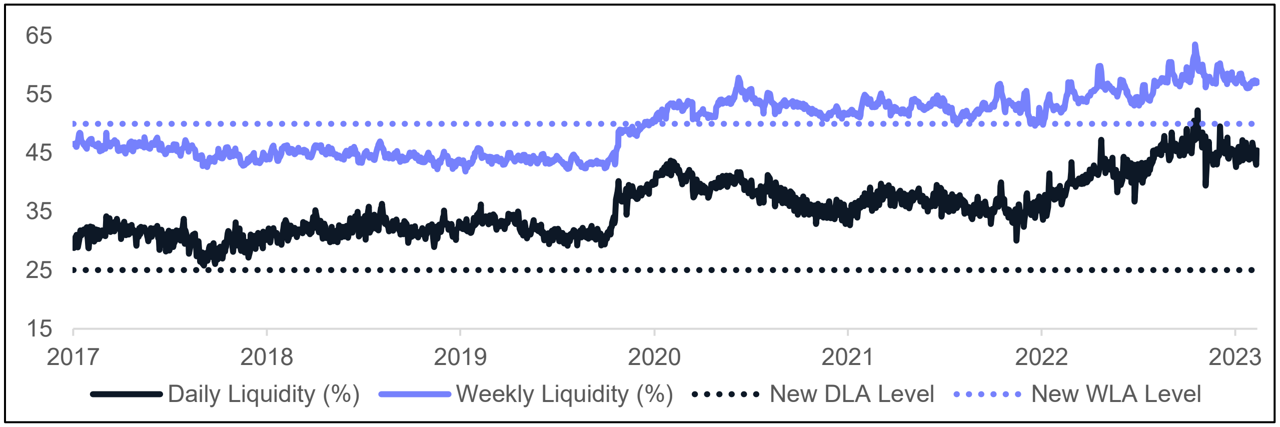
Potential Impacts from Change 4: Raising Liquidity Levels

GOV'T MMFs LIQUIDITY LEVELS (%)



- As expected, based on their eligible investments, government funds are largely unaffected by the new liquidity levels
- There are no expected changes to this category moving forward

PRIME MMFs LIQUIDITY LEVELS (%)



- New liquidity requirements should have a low impact on the current segment as most prime funds are already operating in compliance with the new rules as a result of the rising rate environment and staying short to capture increases in yield
- However, as managers look to extend duration as rates peak, the new constraints will restrict the ability to add term credit (i.e. Credit WAL) and will lean prime funds to express dovish Fed views through government securities
  - Driving the yield spread between prime & government funds closer to zero

Source: iMoneyNet, Goldman Sachs Asset Management. Data as of July 12, 2023. For illustrative purposes only.

Risk Considerations and General Disclosures

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. Money market funds are not subject to credit risk, but will have interest rate risk. Institutional money market funds may have floating net asset values, and will fluctuate depending on market conditions. The Fund's sponsor has no legal obligation to provide financial support to a money market fund, and you should not expect that the sponsor will provide financial support to the money market fund at any time.

Economic and market forecasts presented herein reflect a series of assumptions and judgments as of the date of this presentation and are subject to change without notice. These forecasts do not take into account the specific investment objectives, restrictions, tax and financial situation or other needs of any specific client. Actual data will vary and may not be reflected here. These forecasts are subject to high levels of uncertainty that may affect actual performance. Accordingly, these forecasts should be viewed as merely representative of a broad range of possible outcomes. These forecasts are estimated, based on assumptions, and are subject to significant revision and may change materially as economic and market conditions change. Goldman Sachs has no obligation to provide updates or changes to these forecasts. Case studies and examples are for illustrative purposes only.

Although certain information has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness. We have relied upon and assumed without independent verification, the accuracy and completeness of all information available from public sources.

THIS MATERIAL DOES NOT CONSTITUTE AN OFFER OR SOLICITATION IN ANY JURISDICTION WHERE OR TO ANY PERSON TO WHOM IT WOULD BE UNAUTHORIZED OR UNLAWFUL TO DO SO.

Views and opinions expressed are for informational purposes only and do not constitute a recommendation by Goldman Sachs Asset Management to buy, sell, or hold any security. Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice.

This information discusses general market activity, industry or sector trends, or other broad-based economic, market or political conditions and should not be construed as research or investment advice. This material has been prepared by Goldman Sachs Asset Management and is not financial research nor a product of Goldman Sachs Global Investment Research (GIR). It was not prepared in compliance with applicable provisions of law designed to promote the independence of financial analysis and is not subject to a prohibition on trading following the distribution of financial research. The views and opinions expressed may differ from those of Goldman Sachs Global Investment Research or other departments or divisions of Goldman Sachs and its affiliates. Investors are urged to consult with their financial advisors before buying or selling any securities. This information may not be current and Goldman Sachs Asset Management has no obligation to provide any updates or changes.

This material is provided for informational purposes only and should not be construed as investment advice or an offer or solicitation to buy or sell securities. This material is not intended to be used as a general guide to investing, or as a source of any specific investment recommendations, and makes no implied or express recommendations concerning the manner in which any client's account should or would be handled, as appropriate investment strategies depend upon the client's investment objectives.

Confidentiality

No part of this material may, without Goldman Sachs Asset Management's prior written consent, be (i) copied, photocopied or duplicated in any form, by any means, or (ii) distributed to any person that is not an employee, officer, director, or authorized agent of the recipient.

Date of First Use: July 24, 2023

Compliance Code: 327719-OTU-1838951