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State Controller's Conference for County Auditors

How Money Market Reform Has Impacted
the Short-Term Municipal Market

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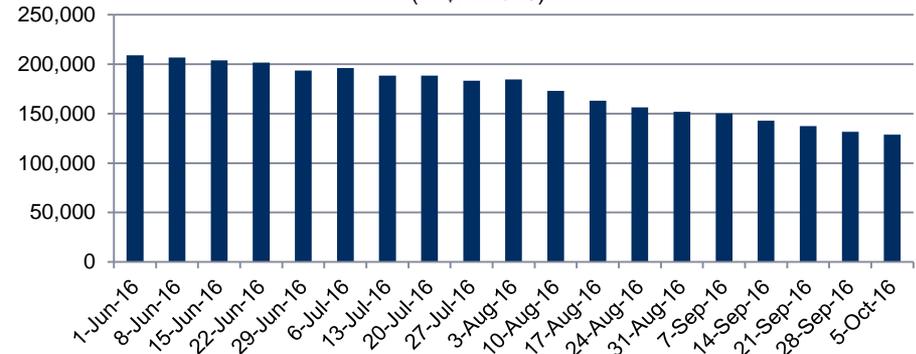
IMPACT OF MONEY MARKET REFORM ON THE SHORT-TERM MARKET

- **As a response to the run on money market funds and “breaking the buck” in the aftermath of the Lehman Brothers meltdown, the SEC has imposed new regulations on money market funds, effective October 14, 2016**
- **The most impactful changes are the imposition of:**
 - i. clear demarcations between “institution” and “retail funds,” and the creation of three distinct fund types: “government,” “prime,” and “municipal”
 - ii. liquidity requirements that require funds to hold a certain percentage of assets in either “daily liquid assets” or “weekly liquid assets”
 - iii. “redemption gates” which limit withdrawals and “liquidity fees” which adversely impact investors’ returns
- **Key features of the new regulations include:**
 - Government Funds will continue using a stable net asset value. Only Government funds are exempt from both the liquidity fee and redemption gate provisions of the new regulations.
 - Institutional Prime and Municipal Funds are now subject to a floating net asset value. Retail Prime and Municipal Funds can still use stable net asset value. All Prime and Municipal Funds are subject to the liquidity fee and redemption gate provisions.
 - Taxable MM funds required to hold at least 10% of their total assets in “daily liquid assets”.
 - Daily liquid assets are cash or a security that will mature or is subject to a demand feature in 1 business day.
 - All MM funds required to hold at least 30% of their total assets in “weekly liquid assets”.
 - Weekly liquid assets are securities that will mature or are subject to a demand feature that is within 5 business days.
 - If “weekly liquid assets” fall below 30% of the fund’s total asset, the fund’s board **would be permitted** to impose a liquidity fee of up to 2% and/ or freeze redemptions up to 10 days in any 90 day period as a gate.
 - If “weekly liquid assets” fall below 10%” the fund’s total assets, the board **would be required** to impose a liquidity fee of up to 2% and or permanently suspend redemptions and liquidate the fund as a gate.

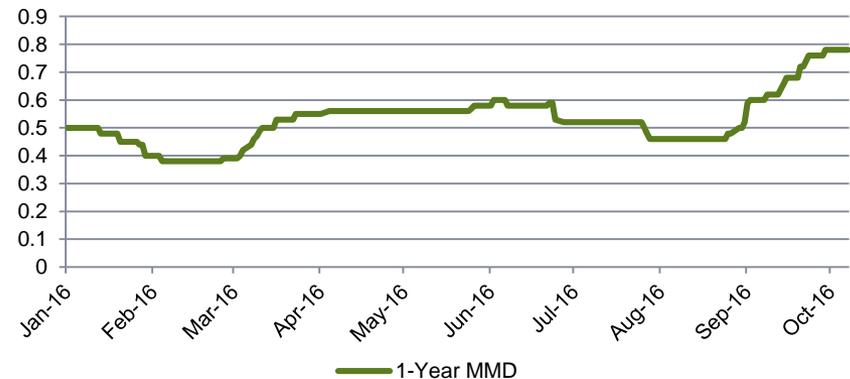
THESE NEW RULES HAVE PROFOUNDLY IMPACTED THE SHORT-TERM MARKET

- Government Funds are not subject to any of the rule changes. Consequently, they have attracted the assets from the Prime and Municipal Funds.
- Municipal Fund Assets have fallen by 50%
 - From \$257 billion to \$128 billion since June
- Additionally, funds have dramatically reduced the WAM of their funds to meet their liquidity constraints
 - Tax-Exempt MMF have a weighted average maturity of 26.6 days versus 31.2 days one year ago
- This has resulted in a pronounced shift of demand towards shorter assets and away from one year notes, with an attendant increase in rates

Tax-Exempt Money Market Funds
(in \$Millions)



1-year MMD
January 1 through Present



EMERGING NEW BUYERS

- Traditionally the “go-to” investor base for one year TRANS, Money Market Funds are on the sidelines
- Short-duration bond funds, money managers , and Separately Managed Accounts (“SMAs” are professional money managers who invest on behalf of high net worth clients through individual portfolios with customized investment parameters)are filling the gap
- Subject to absolute yield levels, other local government investment funds may participate

Riverside County 2016A Teeter Obligation Notes

Investor	Bond Sold	Investor Type
Bel Air Investment Advisors LLC	20,000,000	INVESTMENT MANAGER
Thornburg Investment Management, Inc.	20,000,000	MUTUAL FUND MANAGER
The Vanguard Group, Inc.	8,500,000	MUTUAL FUND MANAGER
Solano County	6,000,000	GOVERNMENT
Northern Trust Asset Mgmt,	5,065,000	BANK-MANAGEMENT DIVISION
Franklin Templeton Investments	5,000,000	MUTUAL FUND MANAGER
Wells Capital Management Inc.	5,000,000	BANK-MANAGEMENT DIVISION
City Of Sacramento	3,000,000	GOVERNMENT
Deutsche Asset & Wealth Management	2,700,000	MUTUAL FUND MANAGER
Citi Investment Mgmt.	2,500,000	INVESTMENT MANAGER
Goldman Sachs Private Wealth	2,000,000	INVESTMENT MANAGER
Northwestern Mutual Life Insurance Co	1,000,000	INSURANCE CO - MGMT DIV
Boston Co. Asset Mgmt.	1,000,000	INVESTMENT MANAGER

OPTIONS TO CONSIDER

- **7-day reset notes directly placed with banks**

- In lieu of procuring a liquidity facility from a bank to support a publicly-offered Variable Rate Demand Note (which is what the Money Funds want to buy), consider a direct placement with a bank
- Obviates the need for disclosure, ratings and lots of brain damage

- **Self-Liquidity**

- For larger counties who carry significant cash balance or who have considerable borrowable resources, it may be possible to structure publicly offered VRDNs with self-liquidity

- **Monthly Resets with Liquidity from Your Treasury Investment Pool**

- “Variable rate lite”—rather than resetting weekly, these notes would reset monthly, and in the event of a failed remarketing, the Pool would purchase the notes, charging a pre-determined spread over the then-prevailing Pool rate
- Why pay a bank, when the Pool can earn a decent fee for taking a risk that it knows better than any investor or bank?

CONCLUSION

- **The new Money Market Fund rules have profoundly altered the short-term muni market**
- **The traditional core investor base for one year TRANs—money market funds—has imploded,**
- **New investor types are getting in the game, but it will take time to educate “bond’ buyers about the credit fundamentals of TRANs**
- **If your County is thinking about TRANs for FY 2018—or implementing an external Teeter Plan, start early and don’t assume what worked before will work going forward. “that was then; this is now”**

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