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CHANGES IN THE MONEY MARKET FUND RULES: THE FIDUCIARY RESPONSE

By Bruce Ashton[1]

The SEC's modifications to the money market fund rules won't become effective for approximately a year, but plan fiduciaries should already be considering what to do about them.[2] Almost certainly, they'll need to make changes in their plan's investments, and they should also be talking to their service providers about how to deal with the changes. In the context of investments, though, the question is, what changes?

As a reminder, the SEC modifications will mandate a floating NAV for money market funds, and permissive or mandatory redemption fees and gates[3], except in the case of government funds (basically limited to U.S. Treasury securities) and "retail" funds[4]. Both will be exempted from the floating NAV requirement, but only government funds will also be freed from the redemption fee and gate requirements (though they can impose them if their boards chose to do so). As others have pointed out, these modifications either mean trading return for stability (since U.S. Treasury securities generally have a lower return than other debt instruments) or running liquidity risk (retail funds with a potentially higher return will be subject to the fees and gates). This sounds like a set of bad choices.

Fiduciaries should take heart. There are other capital preservation vehicles that avoid most of the unpleasant aspects of the "new" money market funds while offering virtually the same level of stability and often a higher rate of return.

Background

Before getting into the investment alternatives that fiduciaries might consider, let's briefly review the fiduciary process for selecting and monitoring investments. Fiduciaries under ERISA must act prudently, which means engaging in a process, a series of steps, to gather and assess relevant information and then make an informed and reasoned decision. The DOL refers to this as an "objective, thorough and analytical search."

In the context of investments, the relevant issues include, among others, (1) where the particular fund[5] fits within the plan's investment strategy, (2) the net yield received and how well the fund performs compared to relevant benchmarks, (3) the stability of the investment team, (4) liquidity of the fund, including issues such as redemption fees and restrictions, and (5) the cost of the fund and compensation paid to its investment manager. To do a thorough job, the fiduciaries need to compare similar investment alternatives, looking at all of the same factors for each, to determine which, based on currently available information, best fits within the plan and serves the interests of its participants.

As this recitation shows, fiduciaries need to go through the same type of assessment for all plan investments, whether they are "simple" money market funds, other fixed income vehicles or complex investment strategies involving multiple layers. So the process that a plan fiduciary will use to consider an alternative to the plan's current money market fund should be neither unusual or strange.

Alternatives to Money Market Funds

Among the alternatives available in the market are cash separate accounts, private money market funds (which are not subject to the SEC rules), short term bond funds and stable value funds. Stable value funds come in a variety of shapes and sizes, but a common approach is for the fund to be under a collective investment trust. For example, two stable value funds sponsored by Reliance Trust are the MetLife Stable Value Fund (Series 25053 - Class 0) (the "MetLife SVF") and the New York Life Anchor Account (Series I - Class 0), both of which are collective investment trusts. For those unfamiliar with CITs, a collective investment trust is a bank-sponsored and managed fund that is available exclusively to retirement plans and is exempt from registration under the federal securities laws. In essence, they operate much like mutual funds, are traded in essentially the same way, are priced daily, but avoid most of the regulatory complications.

Stable value funds offer a return consistent with short- and intermediate-term bond yields but with no downside volatility to the participant because they benefit from a bank or insurance company guarantee against declines. While returns on stable value funds have gone down as the fixed income markets receded,

1 Bruce is a partner in the Employee Benefits & Executive Compensation practice group of the national law firm, Drinker Biddle & Reath LLP. He practices in the Los Angeles office.

2 For further information about the changes and implications for plans, see the June 2015 issue of Reliance Trust Insights, "Money Market Funds Changes – Implications for Plan Sponsors, Plan Administrators and Investment Fiduciaries."

3 A redemption "gate" is a suspension of redemptions from the fund for a limited period, in this case, up to 10 business days.

4 "Retail" funds must limit ownership to natural persons. This may include the accounts of participants in participant-directed plans and forfeiture or suspense accounts in such plans.

5 We use the term "fund" for convenience to refer to various types of investment alternatives.

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when compared to the Morningstar Taxable Money Market Category Average, the decline has been on a gentler curve. In addition, stable value funds are designed to increase participant account balances regardless of what happens in the market generally.

In this sense, stable value funds offer many of the features that plan fiduciaries have found appealing in money market funds: stability and liquidity but with a higher return. For example, consider the returns of the two Reliance Trust stable value funds in the chart below.

Period (as of June 30, 2015)	MetLife SVF*	Reliance NY Life Anchor Account*	Morningstar Taxable Money Market Category Average
One year	2.59%	1.66%	.01%
Three year	2.78%	NA	.02%
Five year	3.09%	NA	.02%
10 year	4.16%	NA	1.3%

* Note – All returns are net of fees.

The MetLife SVF has consistently been highly ranked among stable values funds. It has also out-performed the Morningstar Taxable Money Market Category Average by between 258 and 413 basis points for each of these periods. Of course, there is no guarantee that this fund or any other will continue to perform so well, but these statistics suggest that stable value funds may represent a viable alternative to money market funds without some of the difficulties that the new SEC rules will present.

Looked at from a fiduciary perspective, the process that a plan fiduciary would use to evaluate the stable value fund compared to a money market fund would not differ, with one exception. The fiduciaries would still assess whether the fund fits within the plan's portfolio as an investment offering value stability, how the fund performs (using the Reliance Trust MetLife Series CIT as an example, it significantly out-performs money market funds), stability of the investment team, liquidity of the fund (with no redemption fees or gates in the Reliance Trust MetLife Series) and (5) the cost of the fund (which is highly favorable, as reflected in the returns net of all fees). The only additional issue that a plan fiduciary would need to consider in the stable value fund context is the viability of the insurance guarantee that backs up the fund. Again, in the case of the Reliance Trust MetLife Series, the guarantee is provided by Metropolitan Life, a well-known, highly regarded and highly-rated insurance company.

Next Steps and Timing

The new rules are not effective until October 2016, so why should a fiduciary be thinking about this now? There are a number of factors indicating that now is the best time to start. First, remember that the fiduciaries will need to go through a prudent process of deciding what to do. This means gathering information on what their plan's providers will be doing about the new rules and the money market funds they support. It also means gathering and assessing information about alternatives that will fit the capital preservation role in the plan's investments line-up.

Perhaps more significantly, since money market fund providers will of necessity be making changes, they will be going through a process of seeking shareholder approval of the changes and then, once obtained, going through a process of transitioning a plan's investments from an old fund to one or more new ones. The first step, the vote by fund shareholders, including plan fiduciaries, will require analysis and decision-making, the end product of which may not be readily apparent. In addition, the fiduciaries will need to consider other money market fund alternatives to determine whether to remain with the current provider, select a new one or move to some other investment. The second step will require carefully drawn communications to participants to explain the changes, including the nuances of government funds, retail funds, floating NAVs, redemption fees and redemption gates.

The change to a stable value fund or some other alternative now, especially one with very similar fund characteristics but a higher return and less regulatory complications, may represent a sensible approach that may be simpler to explain and easier for participants to understand.

Conclusion

Regulatory changes sometimes bring with them unexpected complications. The SEC rules on money market funds are one example. They require plan fiduciaries to consider whether to modify the type of money market funds used in the plan, to use several different funds or to replace the money market funds altogether with another capital preservation product that offers many of the same features and protections and potentially a significantly greater return. In this context, fiduciaries may wish to consider a stable value fund as a replacement.

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Bruce L. Ashton
Partner
Los Angeles
(310) 203-4048
Bruce.Ashton@dbr.com

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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.

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