In an effort to address concerns expressed by regulators that money market funds may contribute to financial instability, the Securities and Exchange Commission recently adopted rules intended to change money market funds held by institutional investors.

The rules would require institutional prime and municipal money market funds to move from a stable $1.00 price per share to a floating net asset value. Money market funds sold to individual investors can maintain the fixed $1.00 share price.

The rules allow all money market funds, during times of extreme volatility, to temporarily prevent investors from making withdrawals or to impose fees for investors who redeem shares.

Vanguard is required to comply with these elements of the new rules by October 14, 2016.

The vast majority of investors in Vanguard money market funds will not be affected by the net asset value changes. Those who are affected will have approximately two years to evaluate alternative cash management solutions and make any necessary changes.
A focus on institutional investors

During the financial crisis of 2007–2008, the Reserve Primary Fund “broke the buck,” meaning its net asset value (NAV) dropped below $1.00 per share. This event prompted significant redemptions from institutional prime money market funds, putting them under severe stress and leading the U.S. Treasury to create a temporary guarantee program for money market funds.

Since then, the Securities and Exchange Commission (SEC) has implemented a number of regulatory changes designed to enhance the stability and resilience of all money market funds. In 2010, the SEC issued its first set of new rules for the funds. These rules included tighter restrictions on portfolio holdings, enhanced liquidity and credit quality requirements, and greater transparency.

While these enhancements were favorably received by money market investors, they failed to address the concerns exposed by the highly volatile behavior of institutional investors at the peak of the crisis. During this period, retail investor activity was more balanced, with purchases and redemptions largely offsetting each other. In stark contrast, institutional flows were largely concentrated and one-way, with redemptions far exceeding purchases. This behavior placed added stress on the markets, which the SEC was determined to resolve with its new rules.

Floating NAVs for some funds

The new regulations make a distinction between institutional and retail money market funds.

Prime and municipal/tax-exempt money market funds whose investors are institutions are required to move from a fixed $1.00 share price to a floating NAV. These funds will no longer be allowed to use amortized cost to value portfolio securities. Instead, daily share prices will be calculated using the market-based value of portfolio holdings, rounded to the fourth decimal place.

U.S. government money market funds will be permitted to retain the stable $1.00 per share NAV and may be offered to institutional investors. In order to be considered a government fund, a portfolio is required to invest at least 99.5% of its total assets in cash, government securities, and/or repurchase agreements that are collateralized solely by government securities or cash.

All retail money market funds will also maintain a stable $1.00 share price. In order to be considered a retail fund, the fund must have policies and procedures reasonably designed to limit beneficial ownership to natural persons (for example, accounts associated with social security numbers), including individual beneficiaries of certain trusts and participants in certain tax-deferred accounts, such as defined contribution plans.

Businesses, defined benefit plans, endowments, and other accounts that are not beneficially owned by natural persons will have access only to institutional money market funds.

There are many instances where retail eligibility is currently unclear, including, but not limited to, certain pooled investments holding money market funds, nonqualified investment plans, collective trust investments and money market components of company stock funds or other custom plan funds, retirement plans with forfeiture accounts and short-term investment funds, and donor-advised funds.

Vanguard is working with our counterparts in the industry, various industry groups (e.g., Investment Company Institute), and the SEC to determine the appropriate categorization for these account types and registrations.

Vanguard is required to comply with the new NAV rules by October 14, 2016.

Note on risk: All investing is subject to risk, including the possible loss of the money you invest.

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 per share, it is possible to lose money by investing in such a fund.
Liquidity fees and redemption gates for institutional and retail funds

The SEC’s amendments also include new rules about liquidity fees and gates (temporary suspension of redemptions) allowing a fund’s board of directors to directly address runs on a fund. If deemed appropriate by the fund’s board, fees and gates could be imposed on funds whose portfolios fail to meet certain liquidity thresholds.

The following will apply to both retail and institutional prime and municipal/tax-exempt money market funds:

- If a fund’s weekly liquid assets fall below 30% of its total assets, the board may impose a liquidity fee of up to 2%. Additionally, the board may suspend redemptions for up to 10 business days in a 90-day period.

- If weekly liquid assets fall below 10% of total assets, nongovernment funds are required to impose a 1% liquidity fee, unless the board determines that it would not be in the fund’s best interest or that a higher (up to 2%) or lower fee is more appropriate.

U.S. government money market funds are permitted, but not required, to impose fees and gates.

Although Vanguard has two years to comply with the liquidity fees and redemption gates rules, we don’t anticipate much change to our funds. We’ve always put safety and liquidity ahead of a few extra basis points in yield. In 2010, we increased the liquidity of our funds above their customarily high levels. We expect to be able to manage our funds without fees and gates.

Trigger levels for imposing redemption fees and restrictions (for funds subject to the new rules)

If a fund’s weekly liquid assets fall below 10%:

- The fund is required to impose a 1% redemption fee, unless its board determines otherwise (can range from 0% to 2%).

If a fund’s weekly liquid assets fall below 30%:

- The fund’s board may impose a redemption fee of up to 2%.

The fund may suspend redemptions for up to 10 business days in any 90-day period.

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**SEC Regulations for Money Market Mutual Funds**

Major changes noted in blue

**Retail Funds**

Ownership is restricted to individual investors (defined as “natural persons”)

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<tr>
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<th>Net Asset Value</th>
<th>Redemption fee</th>
<th>Redemption suspension</th>
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<tbody>
<tr>
<td>Prime</td>
<td>Stable at $1.00</td>
<td>Up to 2%</td>
<td>Up to 10 business days</td>
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<tr>
<td>Municipal/Tax-Exempt</td>
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**Institutional Funds**

Ownership is open to all investors, including individual investors

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<th>Net Asset Value</th>
<th>Redemption fee</th>
<th>Redemption suspension</th>
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<tbody>
<tr>
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<td>Floating</td>
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**Retail and Institutional Funds**

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<th>Redemption fee</th>
<th>Redemption suspension</th>
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<tbody>
<tr>
<td>Government</td>
<td>Stable at $1.00</td>
<td>None*</td>
<td>None*</td>
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* Government money market funds are permitted, but not required, to impose redemption fees and restrictions.
Additional changes
The new amendments contain other notable changes. These include enhancements to:

Diversification requirements:
• Adhering to SEC guidelines regarding the extent to which money market fund holdings can be consolidated in securities issued by a specific entity or affiliated group or guaranteed by a specific sponsor or demand feature provider.

Website disclosure requirements:
• Disclosing daily and weekly liquid assets, net shareholder inflows or outflows, market-based NAVs per share, imposition of fees and gates, and any use of affiliate sponsor support.

Reporting obligations:
• Disclosing certain significant events to the SEC, such as the imposition of a fee or gate, or if a portfolio security defaults.
• Amending Form N-MFP with additional information relevant to assessing money market fund risk.

Stress testing:
• Periodically testing the ability to maintain weekly liquid assets of at least 10% and minimize principal volatility.

Although the floating NAV, liquidity fees, and redemption gates will be implemented by the October 2016 deadline, these other changes will take effect sooner.

For Vanguard, it’s business as usual
Money market funds continue to play an important role for Vanguard clients, providing a high-quality and liquid investment, both in stable financial markets and during periods of uncertainty.

We remain confident in the stability of our money market funds, and we continue to manage the funds conservatively and with extreme prudence, focusing on the highest-quality short-term money market instruments.

All of the investments in our money market funds are closely examined by Vanguard Fixed Income Group’s highly skilled and experienced credit analysts. The quality of the underlying issuer is continually assessed through in-depth credit analysis and does not rely on agency ratings alone.

We believe that these changes, along with the safeguards implemented in 2010, constitute a strong response to concerns that institutional money market funds may pose a risk to the financial system. While the majority of Vanguard money market fund shareholders won’t be affected by the new rules, some institutional clients will be. Vanguard is in the process of evaluating the changes and the impact on our shareholders. We’re confident that we’ll be able to provide a viable cash management vehicle for all of our shareholders within the necessary time frame.