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INVESTMENT MANAGEMENT

Money Market Fund Reform: Where Are We Now?

On June 5th, the SEC voted to propose rules that would reform the way money market funds operate. These proposed rule changes will not alter the existing structure or management of money funds until such time as final rules are issued and in effect. Schwab has been an active participant in the reform discussion to this point and we look forward to continuing our involvement in the future.

Money market funds represent more than 70% of the assets managed by Charles Schwab Investment Management. As the fifth largest domestic sponsor of money market funds, Charles Schwab remains committed to preserving the value and benefits money market funds have historically provided to investors.

Below are questions and answers to help our shareholders understand where the money market reform process stands.

Q. Why is the SEC recommending reform?

A. In March 2010, the Commission adopted a series of amendments designed to make money market funds more resilient by reducing the interest rate, credit, and liquidity risks of their portfolios. Schwab was supportive of these amendments. Although these reforms improved money market fund resiliency, the Commission said at the time that it would continue to consider whether further, more fundamental changes to money market fund regulation might be warranted. The proposal introduced on June 5th represents these further regulations.

Q. What did the SEC announce on June 5th?

A. On June 5th, the SEC approved the proposal of rules that would reform the way money market funds operate. **It is important to note that any potential changes are subject to a lengthy rule making process, and depending on the final reform recommendations, the industry will have from nine months to two years to implement changes after the final rules have been approved.**

The proposed amendments present two alternatives which could be adopted alone or in combination:

- Floating the net asset value (NAV) for prime institutional money market funds and
- Using liquidity fees and redemption gates in times of stress

In addition, the SEC suggested enhancements to money market fund disclosures, reporting, diversification requirements, and stress testing.

Q. What does this mean for money market fund shareholders?

A. The SEC's proposal will not change the management of any type of money market fund in the immediate term. Any potential changes are subject to a lengthy rule making process, and depending on the final reform recommendations, the industry will have from nine months to two years to implement changes after the final rules have been approved.

Q. What is a prime institutional money market fund?

A. A prime money market fund primarily invests in short-term securities issued by corporations and financial institutions (e.g., commercial paper, bank certificate of deposits, etc.). This differs from government money funds, which primarily invest in securities issued by the US Treasury, Federal Agencies and Government Sponsored Enterprises (e.g., Federal Home Loan Bank, Fannie Mae).

In the SEC proposal, an institutional money market fund is defined as a fund that allows a shareholder to withdraw more than $1 million per business day. A retail money market fund is one that does not permit a shareholder to redeem more than $1 million per business day.

Q. Why is reform focused on prime institutional money market funds?

A. In December 2012, the SEC published a study relating to money market funds. The study showed at the height of the financial crisis in September 2008, prime institutional money market funds experienced heavy redemptions of approximately $300 billion. These redemptions prompted the SEC to evaluate the need for money market fund reform.

The study also indicated that government money market funds generally are not susceptible to heavy redemptions or runs due to the nature of their portfolio assets. Retail investors have historically been less likely to redeem heavily from such funds in times of financial stress.

Q. Am I currently invested in a prime institutional money fund?

A. The SEC does not currently apply this definition to money market funds. The SEC's proposal suggests a retail money market fund would be defined as a money market fund that limits each shareholder's redemptions to no more than $1 million per business day.

Q. How are the Schwab Treasury, Treasury Obligations, and Government money market funds affected by the proposals?

A. The SEC's proposal exempts most treasury and government money market funds from the floating NAV and liquidity fees and redemption gate requirements. The Schwab treasury and government money market funds will not likely be impacted by these two proposals. Note, however, that the proposal also includes proposed enhancements to money fund disclosures, reporting, diversification requirements, and stress testing, which, if adopted, will likely apply to all money market funds.

Q. How are municipal money market funds affected by the proposals?

A. Unlike treasury and government money market funds, there is no exemption for municipal money market funds from the proposed floating NAV or liquidity fees and redemption gate requirements. However, it is anticipated that most municipal (or tax-exempt) money market funds will not likely be impacted given that municipal money market funds are primarily used by retail, rather than institutional investors.

Q. What is the anticipated timeline for potential reform?

A. The process of implementing potential reform, if the SEC's recommendations are adopted, will take place over an extended period of time. After the proposal is published in the Federal Register in the coming days, a comment period scheduled to last 90 days will begin. The SEC will then review submissions from both the industry and the general public, a process that could last several months.

Thereafter, the SEC can decide to offer a formal reform recommendation on which the five SEC Commissioners will vote. If a majority of the Commissioners support the recommendations, money market fund reform will officially be adopted. If the recommendations that emerge after the comment period are materially different from those issued on June 5th, another round of public comments may be required.

The SEC has suggested sponsors would have between nine months and two years, from the time regulations are adopted, to become compliant with the currently proposed recommendations. The compliance period will vary between nine months and two years depending on which reforms are ultimately adopted by the SEC.

Q. What is Schwab's view on the proposal?

A. Schwab recognizes a clear difference between money market funds that are used by retail and institutional investors. We believe that allowing retail money funds to continue offering a constant $1.00 NAV preserves an important product used by millions of retail investors for managing their cash flow and investment needs. Schwab looks forward to thoroughly reviewing the SEC proposal, being an active and constructive participant in the rule making process, and supporting the long-term viability of money market funds.

For more information, please visit the SEC's press release "SEC Proposes Money Market Fund Reforms" which is available on the SEC website.

An investment in a money market fund is neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although money market mutual funds seek to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in such funds.

Investors should carefully consider information contained in the prospectus, including investment objectives, risks, charges, and expenses. Please read the prospectus carefully before investing.

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