

ICI OPERATIONS

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# Reverse Distribution Mechanism and Negative Yields: Considerations and Recommended Practices

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# Reverse Distribution Mechanism and Negative Yields: Considerations and Recommended Practices

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## Foreword

As part of its overall response to the COVID-19 pandemic and its effects on the US economy, the Federal Reserve reduced its target range for the federal funds rate, the rate at which banks lend and borrow excess reserves overnight, to 0.0 to 0.25 percent. This reduction has caused yields on short-term securities, including Treasury securities, to decline to very low levels. The policy has increased the likelihood that some constant net asset value (CNAV) money market funds will post negative yields after accounting for expenses, due to the number of affected securities these funds tend to hold.

In response, CNAV money market funds are exploring several actions to mitigate the pressure of negative yields. Potential mitigating actions include the following:

- » Implementing fee waivers and/or soft closures (e.g., close funds to new investors and new money).
- » Contributing a fund sponsor's own capital to stabilize the net asset value (NAV) and maintain a non-negative yield.
- » Converting from a CNAV money market fund to a floating NAV using processes developed in response to 2014 money market fund reforms from the Securities and Exchange Commission (SEC).<sup>1</sup>

Additional alternatives involve reducing or cancelling full and fractional CNAV money market fund shares on a pro rata basis to offset the negative yield and enable the fund to maintain a constant NAV. These options include the following:

- » Daily reverse stock split
- » Accrue negative yield and periodically post to shareholder accounts
- » Reverse Distribution Mechanism (RDM)<sup>2</sup>

The Investment Company Institute (ICI) convened a working group of funds, intermediaries, and their respective service providers to discuss the operational feasibility of these share cancellation alternatives. In the end, the daily reverse stock split and negative yield accrual alternatives were deemed operationally unworkable due to a combination of current system capabilities, operational risks, and the cost and time needed to scale them for widespread use.

The working group identified RDM as the most operationally feasible alternative should a CNAV money market fund have to apply negative yield quickly. This paper provides details on RDM and highlights recommended practices for successful implementation of RDM, should it become necessary.

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<sup>1</sup> Floating NAV money market funds (i.e., prime institutional) will reflect negative yield on securities through a decline in NAV, so they are not part of this discussion.

<sup>2</sup> Use of share cancellation by a CNAV money market fund is subject to individual business decision. Funds are encouraged to seek the advice of counsel before pursuing any share cancellation methodology.

## Introduction

RDM distributes a CNAV money market fund's negative yield by cancelling shares in shareholder accounts. It offsets the daily negative yield accrued (i.e., a decline in the fund's net assets) by reducing the number of fund shares outstanding. This process allows the fund to maintain a constant NAV per share, typically \$1.00. The fund allocates the reduction in shares outstanding pro rata across all eligible shareholder accounts by posting a share redemption/cancellation transaction to each shareholder's account based on the daily negative yield factor per share.<sup>3</sup> To ensure they apply reductions to all eligible shareholders, funds and intermediaries must post share cancellations to their respective systems daily.<sup>4</sup> Shares included in the RDM calculation are determined using the same criteria used to distribute positive income.

It is anticipated that funds would make the daily negative yield factor per share available around the same time of day as other positive income factors per share (also known as daily accrual factors). Members of the RDM Feasibility Working Group indicated that, should they need to implement RDM, they plan to apply their share cancellation transactions each day prior to the initiation of their nightly processing cycles.

Whatever share cancellation alternative that funds choose to manage negative yield situations for a CNAV money market fund, they should consider proactively communicating their intention to their intermediary partners. In addition to assisting counterparties in their preparations, transparency will help ensure consistent accounting for negative yield when it is necessary. For instance, fund accounting for share cancellation (e.g., RDM) differs from fund accounting for reductions in accrued dividends (e.g., negative yield accrual). To maintain accurate fund accounting and reporting, all parties must pursue the alternative determined by the fund.

## Reverse Distribution Mechanism High-Level Life Cycle

Successful execution of RDM involves numerous parties, especially when applied to accounts serviced through an intermediated business model. Such parties may include the following:

- » Fund accounting
- » Fund transfer agent
- » Depository Trust & Clearing Corporation (DTCC)
- » Intermediary<sup>5</sup>
- » Brokerage platform

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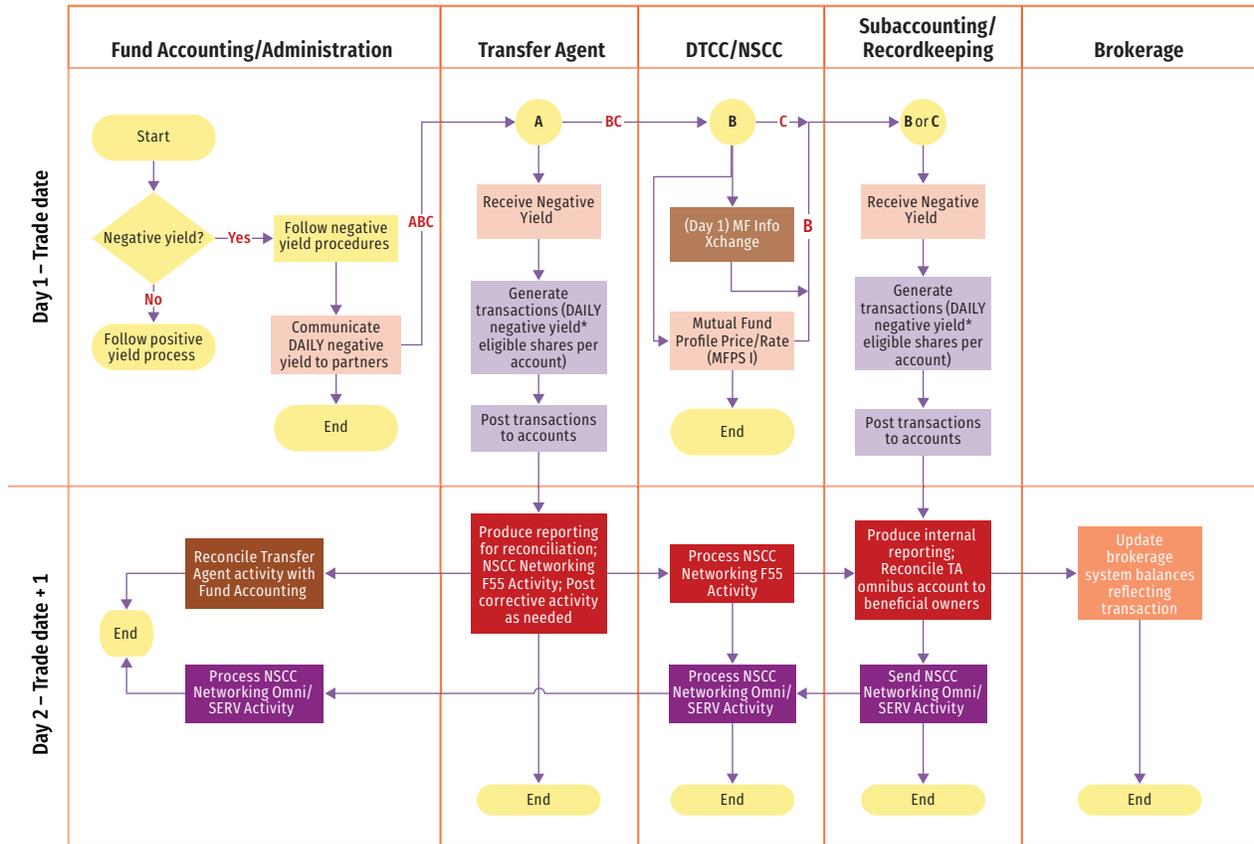
<sup>3</sup> Shares are reduced regardless of dividend election of the underlying shareholder (e.g., cash vs. reinvestment).

<sup>4</sup> Failure to process the RDM daily could lead to "gaming" by shareholders—for example, if shares are cancelled periodically, a shareholder could redeem all account shares before a share cancellation is applied.

<sup>5</sup> Intermediaries include broker-dealers, retirement recordkeepers, insurance companies, bank/trust companies, and private wealth management firms. Omnibus intermediaries use one or a few accounts at the mutual fund transfer agent to hold shares that are registered in the name of the financial intermediary. The intermediary maintains the underlying shareholder account information on its own recordkeeping systems—a process known as subaccounting—and typically reports share transactions to the funds on an aggregate basis. The intermediary or its agent handles all communications and servicing of its customer accounts.

The following image illustrates a simplified life cycle of how a negative yield factor is disseminated and processed through RDM to cancel shares, including intermediated business, when following the working group’s recommended practices.<sup>6</sup>

**EXHIBIT 1**  
**RDM High-Level Life Cycle**



<sup>6</sup> The following discussion covers the steps that may be necessary to determine, calculate, and apply the RDM. Organizations may follow their own business practices that may diverge from this workflow.

## Day 1

- » Fund accounting determines that a negative yield must be declared.
- » Fund accounting shares the daily negative yield factor with recordkeepers (e.g., fund transfer agent, intermediary subaccountants, retirement plan recordkeepers). Business models and system capabilities determine how and to whom yield factor communication occurs.
  - » The most common strategy is to communicate from fund accounting through the transfer agent (workflow A), which uses DTCC's Mutual Fund Profile Price/Rate Service (MFPS I)<sup>7</sup> to communicate to intermediaries (workflow B).
  - » Fund accounting may also communicate directly with some intermediaries; however, this is typically accomplished via email (workflow C).
- » The working group recommends separate communications by funds to counterparties on the first day a daily negative yield will be provided. Funds could make this process more efficient and effective by leveraging various communication solutions, such as DTCC's MF Info Xchange<sup>8</sup> and other third-party or proprietary solutions.
- » The working group recommends communicating daily negative yield factors in the same manner as funds communicate daily positive income factors. Many organizations use MFPS I, which introduced the ability to communicate daily negative income factors as of November 23, 2020. Organizations that provide income factors by other means should continue to do so.
- » Recordkeepers are responsible for calculating RDM against shareholders' income-eligible share balances and creating and posting the related RDM share cancellation transactions. Note that the shares are removed (cancelled). No proceeds are paid to the shareholder or remitted by intermediaries to the fund.

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<sup>7</sup> MFPS I Daily Price and Rate File provides fund companies with an automated solution for delivering prices and daily distribution rates to their intermediaries. See [www.dtcc.com/wealth-management-services/mutual-fund-services/mutual-fund-profile-service-i](http://www.dtcc.com/wealth-management-services/mutual-fund-services/mutual-fund-profile-service-i).

<sup>8</sup> MF Info Xchange (MFI) facilitates, centralizes, and standardizes the delivery and receipt of time-critical notifications, including corporate actions, service disruptions, and other critical alerts, which typically require communications from funds to their intermediary partners. See [www.dtcc.com/wealth-management-services/mutual-fund-services/mf-info-xchange](http://www.dtcc.com/wealth-management-services/mutual-fund-services/mf-info-xchange).

## Day 2

- » Reconciliation of RDM-related activity will be a complex give-and-take between funds and intermediaries.
- » Funds will need to consider any as-of transaction activity submitted by intermediaries that affects previously determined RDM share cancellation activity, and post updates to accounts.
- » Intermediaries will need to reconcile the fund's activity posted to their accounts at the transfer agent with activity on their own recordkeeping systems.
- » Intermediaries using a brokerage platform will need to ensure all positions are updated to reflect the effects of the RDM activity.
- » DTCC serves as a conduit for sharing RDM activity and communicating daily negative yield.
- » As-of transactions may be received in several ways. The most common is through the DTCC Fund/SERV® Defined Contribution Clearance and Settlement (DCC&S) platform.<sup>9</sup>
- » Funds will need to communicate RDM-related transactions posted to intermediary accounts on the fund's transfer agent system. This task is commonly handled via National Securities Clearing Corporation (NSCC) Networking F55 activity records.<sup>10</sup>
- » Omnibus intermediaries will need to include RDM-related activity posted to their beneficial owner accounts in transparency or sales reporting feeds. Such information is often conveyed via NSCC Networking Omni/SERV DSA (activity) records.<sup>11</sup>
- » Fund accounting reconciles the shares cancelled via RDM on the transfer agent system with the fund's records of what is necessary to maintain a constant NAV.

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<sup>9</sup> Fund/SERV® DCC&S transaction activity reflects the net impact of the previous business day's transactions received by omnibus intermediaries that were processed on recordkeeping and subaccounting systems through nightly processing cycles and transmitted to funds through a series of NSCC Fund/SERV cycles occurring in the early morning on T+1. DCC&S transactions are settled on date of receipt. See [www.dtcc.com/wealth-management-services/mutual-fund-services/defined-contribution-clearance-and-settlement](http://www.dtcc.com/wealth-management-services/mutual-fund-services/defined-contribution-clearance-and-settlement).

<sup>10</sup> NSCC Networking is an industry standard that streamlines exchange of information at the customer account level, including account transactions between funds and broker-dealers. See [www.dtcc.com/wealth-management-services/mutual-fund-services/networking](http://www.dtcc.com/wealth-management-services/mutual-fund-services/networking).

<sup>11</sup> Omni/SERV® provides a streamlined communication platform for the transmission of activity and position files for fund accounts held in omnibus, enabling participating trading partners to share subaccount information and creating transparency for omnibus relationships. See [www.dtcc.com/wealth-management-services/mutual-fund-services/omni-serv](http://www.dtcc.com/wealth-management-services/mutual-fund-services/omni-serv).

## Calculating RDM

In its simplest form, RDM is the daily pro rata distribution of the fund's daily accrued negative income against shareholders' eligible account balances. The following steps illustrate how RDM is determined and applied using a simple, hypothetical example with the following assumptions:

1. Fund net assets on day 1 are \$10,000,000; income-eligible shares are 10,000,000.000.
2. The fund experiences no other transaction activity during the day.
3. The portfolio yield is negative 10 basis points (bps) annualized (-0.0010).
4. Fund expenses are 15 bps annualized and are being waived by the fund adviser.
5. The net yield, after all waivers, is negative 10 bps.

Negative income accrued is determined by multiplying fund net assets by the daily negative yield.<sup>12</sup> The equation is  $\$10,000,000 * (-0.0010/365) = \$27.40$ . At \$1.00/share NAV, the fund must cancel 27.40 outstanding shares.

The daily negative yield factor per share is determined by dividing the shares that must be cancelled by the total income-eligible shares of the fund—the shares that would otherwise receive positive income or that must be used to cover negative income. The equation is  $-27.40/10,000,000 = -0.0000274$ .

The daily negative yield factor is provided to all recordkeepers, which multiply it by the number of income-eligible shares in each shareholder account they hold, thereby determining the pro rata distribution of the share cancellation for each shareholder. In this example, if a shareholder has \$10,000, the equation is  $10,000 \text{ shares} * -0.0000274 = -0.027$ . Since CNAV money market shares are held to two decimal places, the share cancellation gets rounded to -0.03. The account balance becomes \$9,999.97 and 9,999.97 shares.

On day 2, the fund has \$9,999,972.60 in net assets and 9,999,972.60 shares outstanding.

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<sup>12</sup> Daily negative yield = Annual negative yield/365.

## RDM Considerations

The use of RDM requires the following considerations:

1. RDM applies to the same “income-eligible” shares that would otherwise earn positive income. These are shares acquired and held based on the fund’s rules and policies. Note that the rules and policies governing income-eligible shares may vary from one CNAV money market fund to another, both within and across fund families. In many instances, the income-eligible shares may represent a subset of the overall fund’s holdings or a portion of an individual’s account balance.
2. Any CNAV money market fund that strikes multiple NAVs per day and chooses to use RDM may have additional considerations and disclosures.
3. To ensure appropriate participation of all eligible shareholders in share cancellation, daily RDM share cancellation must occur prior to paying out full redemption requests.
4. Funds and intermediaries offering CNAV money market funds that calculate income through settlement date may need to review their full redemption practices. Alternatives may include changes to fund policies, including updated disclosure and fund documents, or to operational procedures, such as to retain enough principal shares to cover RDM obligations between transaction confirmation and settlement.

## Determining Income Eligibility

It is important to consider the characteristics of a given CNAV money market fund when evaluating RDM implementation. Most notably, it is important to understand what types of activity are income-eligible, and when eligibility begins and ends.

Major CNAV money market fund characteristics may affect the fund's RDM calculation:

- » **AM/PM:** Some funds have policies that consider the time of transaction when determining income eligibility. For instance, transactions placed prior to a certain time may affect income-eligible shares today, while those received after such time may not affect income eligibility until the next business day.
- » **Pay on credit/pay on debit:** This distinction refers to when income eligibility on shares starts and ends based on type of activity. Pay-on-credit funds begin income eligibility on the date shares are acquired and end income eligibility on the date shares are redeemed. Conversely, pay-on-debit funds begin income eligibility on the day after shares are acquired and end income eligibility on the day after shares are redeemed (or, in some cases, through trade settlement).

These rules are not exclusive to income eligibility for RDM. The same rules also determine income eligibility for positive income. As a result, any routines funds already have in place to derive income-eligible shares will work for RDM, except as otherwise noted.

## The Role of “As-of” Activity and Income-Eligible Shares

Significant transaction activity coming from omnibus intermediaries is received on the morning of the first business day after trade date (i.e., trade date plus 1, or T+1), through services such as Fund/SERV® DCC&S. Depending on the CNAV money market fund's characteristics regarding AM/PM or pay on credit/debit, as-of activity may change an account's income-eligible shares.<sup>13</sup> The following discussion illustrates the effect of different income-eligibility rules on the same transaction activity on two different CNAV money market funds.

### *Pay on Credit and “As-of” Activity*

A pay-on-credit fund's as-of activity could alter the income-eligible shares for the previous business day, which could lead to a necessary adjustment to the RDM transaction already posted to the omnibus account by the fund. Such adjustment would be necessary when one or more of the intermediary's beneficial owners of the omnibus account adjusts income-eligible shares through transaction activity.

The following example assumes that November 17 is the first day that RDM applies to a money market fund. This fund treats credit activity as income-eligible on the date shares are acquired. On November 17, the beneficial owners acquire an additional 250,000 shares of the fund through the intermediary, acting as agent for the fund. Actual trade information is not communicated to the fund until T+1 via DCC&S. The table illustrates how a fund that needs to apply RDM activity on November 17 would be required to apply an additional corrective transaction on the next business morning, to account for the effect of unknown intermediary activity processed on trade date on income-eligible shares.

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<sup>13</sup> Although this section focuses on the as-of activity of omnibus intermediaries, the same adjusting steps apply for any as-of activity in a CNAV money market fund.

## EXHIBIT 2

## Pay-on-Credit CNAV Money Market Fund Under RDM with As-of Activity

Omnibus account on transfer agent system	Description	Intermediary beneficial owner activities
<b>November 17 (first day of RDM)</b>		
<b>1,000,000.000</b>	<i>Initial</i> income-eligible shares on November 17	1,000,000.000
	Aggregate purchases on November 17	+ 500,000.000
	» Income-eligible beginning November 17	
	» Added to initial income-eligible shares	
	Aggregate redemptions on November 17	- 250,000.000
	» Not income-eligible beginning November 17	
	» Subtracted from initial income-eligible shares	
	<i>Adjusted</i> income-eligible shares on November 17	1,000,000.000
	» The intermediary system already knows the activity from November 17; it should automatically update with correct income-eligible shares	+ 500,000.000
		- 250,000.000
<b>1,000,000.000</b>		<b>1,250,000.000</b>
1,000,000.000	RDM for November 17	1,250,000.000
* - 0.00000274	» Apply -10 bp annual yield as a daily negative yield of -0.00000274 to all income-eligible shares	* - 0.00000274
<b>-2.740</b>		<b>-3.430</b>
<b>November 18</b>		
1,000,000.000	<i>Initial</i> income-eligible shares on November 18	1,250,000.000
<u>- 2.740</u>		<u>- 3.430</u>
<b>999,997.260</b>		<b>1,249,996.570</b>
+ 500,000.000	Aggregate purchases from November 17 sent through DCC&S the morning of November 18	
	» Income-eligible beginning November 17, and therefore affect the November 17 RDM calculation	
	» Added to initial income-eligible shares for November 18	
- 250,000.000	Aggregate redemptions on November 17 sent through DCC&S the morning of November 18	
	» Not income-eligible beginning November 17, and therefore affect the November 17 RDM calculation	
	» Subtracted from initial income-eligible shares for November 18	
+ 500,000.000	RDM for November 17	
<u>- 250,000.000</u>	» Apply -10 bp annual yield as a daily negative yield of 0.00000274 to all newly received income-eligible shares	
<b>250,000.000</b>		
* - 0.00000274		
<b>-0.690</b>		
999,997.260	<i>Adjusted</i> income-eligible shares for November 18.	
+ 500,000.000	» This adjustment must be made prior to any use of RDM for November 18.	
<u>- 250,000.000</u>		
<u>- 0.690</u>		
<b>1,249,996.570</b>		<b>1,249,996.570</b>

It is important for funds and intermediaries to understand how RDM activity could extend the reconciliation process for pay-on-credit funds. For instance, following industry best practice to send RDM transaction activity to intermediaries via Networking F55 will result in two transactions related to the RDM processed on November 17 in Exhibit 2:

- » November 18: Networking F55 RDM activity for -2.740 shares processed on November 17
- » November 19: Networking F55 RDM activity for -0.690 shares processed the morning of November 18 because of overnight DCC&S as-of activity

### ***Pay on Debit and “As-of” Activity***

A pay-on-debit fund’s as-of activity could alter the income-eligible shares for the current business day. In that case, the fund would have to adjust the initial income-eligible shares. However, the fund would not have to adjust any RDM transactions it had already posted to the omnibus account.

The following example assumes that November 17 is the first day that RDM applies to a money market fund. This fund treats credit activity as income-eligible on the first day following share acquisition. Debits are income-eligible through trade date. On November 17, the beneficial owners acquired an additional 250,000 shares of the fund through the intermediary, acting as agent for the fund. Actual trade information is not communicated to the fund until T+1 via DCC&S. Exhibit 3 illustrates how a pay-on-debit fund that applied RDM on November 17 and received trading activity on the morning of November 18 would be required to adjust its income-eligible shares for the current business day (November 18).

## EXHIBIT 3

## Pay-on-Debit CNAV Money Market Fund Under RDM with As-of Activity

Omnibus account on Transfer agent system	Description	Intermediary beneficial owner activities
<b>November 17 (first day of RDM)</b>		
<b>1,000,000.000</b>	<i>Initial</i> income-eligible shares on November 17	<b>1,000,000.000</b>
	Aggregate purchases on November 17	+ 500,000.000
	» Income-eligible beginning November 18	
	» No change to November 17 initial income-eligible shares	
	Aggregate redemptions on November 17	- 250,000.000
	» Income-eligible through November 17	
	» No change to November 17 initial income-eligible shares	
<b>1,000,000.000</b>	<i>Post-activity</i> income-eligible shares on November 17	<b>1,000,000.000</b>
1,000,000.000	RDM for November 17	1,000,000.000
* - 0.00000274	» Apply -10 bp annual yield as a daily negative yield of 0.00000274 to all income-eligible shares	* - 0.00000274
<b>-2.740</b>		<b>-2.740</b>
<b>November 18</b>		
1,000,000.000	<i>Initial</i> income-eligible shares on November 18	1,000,000.000
<u>- 2.740</u>	» The intermediary system already knows the activity from November 17; it should automatically update with correct income-eligible shares	+ 500,000.000
		- 250,000.000
		<u>- 2.740</u>
<b>999,997.260</b>		<b>1,249,997.260</b>
+ 500,000.000	Aggregate purchases from November 17 sent through DCC&S the morning of November 18	
	» Income-eligible beginning November 18	
	» No change to November 17 initial income-eligible shares	
	» Does not affect the November 17 RDM calculation	
	» Increase to initial income-eligible shares for November 18	
- 250,000.000	Aggregate redemptions on November 17 sent through DCC&S the morning of November 18	
	» Income-eligible through November 17	
	» No change to November 17 initial income-eligible shares	
	» Does not affect the November 17 RDM calculation	
	» Decrease to initial income-eligible shares for November 18	
999,997.260	<i>Adjusted</i> income-eligible shares for November 18	
+ 500,000.000	» This adjustment must be made prior to any use of RDM for November 18	
<u>- 250,000.000</u>		
<b>1,249,997.260</b>		<b>1,249,997.260</b>

RDM reconciliation that follows industry best practice to send RDM transaction activity to intermediaries via Networking F55 will result in one transaction, sent the morning of T+1, to reconcile November 17's RDM.

- » November 18: Networking F55 RDM activity for -2.740 shares processed on November 17.

In both scenarios, the fund is required to resolve the November 17 income-eligible shares and prepare for an accurate calculation of RDM (if applicable) on November 18 (T+1). These scenarios demonstrate the importance of timely communication of trading information by intermediaries and completion of related reconciliation activities by all parties. Both activities may become more difficult if additional as-of transactions are received, such as those that come through sources other than DCC&S or other standardized processing platforms, or when the as-of activity covers multiple days that are subject to an RDM.

### Extended Corrections and Their Effect on RDM

Regardless of when activity occurs, any transaction with an effective date that coincides with a fund's use of RDM must be evaluated for its effects on share cancellation. Whether an RDM share cancellation transaction is necessary is based entirely on the income eligibility of the transaction shares on the date in question. As-of activity crossing multiple dates on which a fund uses RDM may, in turn, require multiple new RDM share cancellation transactions to be posted to an account, or existing RDM share cancellation transactions to be adjusted due to the new activity.<sup>14</sup>

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#### EXHIBIT 4

#### Hypothetical Timeline Illustrating RDM Applicability to a CNAV Money Market Fund

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The above timeline represents five business days, the second through the sixth, of a given month. Dates in orange indicate negative yield and the use of RDM for income-eligible shares, while dates in white indicate zero (or positive) yield without use of RDM. The fund is a pay-on-debit fund, meaning acquired shares become income-eligible on the next business day, while sold shares remain income-eligible through the current business day.

Any as-of transaction that results in a change to income-eligible shares for the second, fifth, or sixth of the month will require consideration of a corresponding RDM transaction—either a new transaction or changes to an existing transaction—signified by a “yes” in Exhibit 5.

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<sup>14</sup> An as-of credit transaction may result in additional shares cancelled due to RDM, while an as-of debit transaction may result in RDM-cancelled shares being returned to the shareholder's account.

EXHIBIT 5

**Extended Corrections and Effects on RDM Correction**

Today's date	As-of date	Change to income-eligible shares	2	3	4	5	6	Comments
4	3	Increase	N/A	No	No	N/A	N/A	No RDM was applied on either the 3rd or 4th of the month, so no correction is needed.
5	3	Decrease	N/A	No	No	No	N/A	No RDM was applied on either the 3rd or 4th, so no correction is needed. The income-eligible shares on the 5th would need to be decreased prior to applying the RDM on the same day.
6	2	Increase	No	No	No	Yes	Yes	Shares acquired on the 2nd become income-eligible on the 3rd, so no correction is needed for the 2nd. Correction is needed for the increased share balance for the 5th and 6th.
6	2	Decrease	No	No	No	Yes	Yes	Shares decreased on the 2nd are income-eligible on the 2nd, so no change to the existing RDM for the 2nd. Correction is needed for the decreased share balance for the 5th and 6th.
6	5	Increase	N/A	N/A	N/A	No	No	Shares acquired on the 5th become income-eligible on the 6th, so no correction is needed for the 5th. The income-eligible shares on the 6th would need to be increased prior to applying the RDM on the same day.

There is no prescribed method for posting corrective activity to individual shareholder accounts. In some instances, the recordkeeper (e.g., fund transfer agent, intermediary subaccounting agent, retirement recordkeeper, etc.) may choose to cancel any existing RDM transactions and replace them with new RDM transactions that reflect an updated amount. In other instances, recordkeepers may use RDM transactions that reflect the incremental change due to the correction. In all instances, activity should be reported between counterparties, preferably following the recommended practices described in this document.

## Other Factors Affecting Use of RDM

Beyond determining the income eligibility of shares, additional factors must be evaluated while considering or using RDM. These factors include the ability to use RDM with certain funds that strike multiple NAVs, the processing of full redemptions in a fund under RDM, and the effects of fund settlement timing on the RDM calculation.

### Multi-NAV Fund Considerations

To provide greater flexibility to shareholders that require intra-day access to their funds, multi-NAV CNAV money market funds typically may calculate NAVs and redeem shares up to four times per day. These CNAV money market funds often disclose in their prospectuses that the distribution of income only occurs once daily, based on the income-eligible shares held in an account at the “end of day.” Some CNAV money market funds may consider using the same methodology when completing the pro rata distribution of daily negative income under RDM.

By waiting until the end of day to determine income-eligible shares used to calculate RDM, any shares redeemed under earlier intra-day NAV strikes would not be included in RDM share cancellation. Prior to pursuing RDM, it is strongly recommended that multi-NAV CNAV money market funds consult with counsel as well as review prospectus language and any policies regarding income entitlements to ensure their application of RDM is appropriately disclosed to shareholders.

### Full Redemptions Increase RDM Complexity

Certain CNAV money market funds offer the ability to process full (sometimes called “all-share”) redemptions and to release proceeds to shareholders prior to the close of the Federal Reserve’s wire transfer window on any given business day. This level of efficiency creates challenges for a CNAV money market fund using RDM. If an account has income-eligible shares that should be included in that day’s RDM calculation, the RDM share cancellation would have to occur prior to any full redemption. Failure to do so would mean the redeeming shareholder’s account may not be allocated its pro rata share of the day’s negative income based on the income-eligible shares it holds.

The working group discussed a few alternatives to address processing the RDM transaction prior to a full redemption. Most involved systematically pausing the processing of an “all-share” redemption from the CNAV money market fund until the RDM share cancellation transaction is posted, after which the all-share redemption would be released for processing. This could delay the proceeds being sent to the shareholder until the following morning. Some working group members discussed a variation by which two transactions could be submitted—with the larger of the two a partial redemption designed to pay most of the redemption proceeds to the shareholder, and the second smaller all-share transaction designed to close out the account following the RDM share cancellation transaction.

## Income-Eligible Shares and Settlement

Each CNAV money market fund has its own settlement cycle. Settlement is an important consideration, as it often plays a role in when shares lose their income eligibility. For example, a CNAV money market fund operating as a pay-on-debit fund that observes a T+2 settlement cycle for its activity might consider shares income-eligible for two days *after* a redemption is posted to the account—until settled. As a result, those shares would need to participate in RDM for two days after they have been redeemed from the account. This is likely less of a concern for accounts experiencing a partial share redemption, because any RDM share cancellation may be applied against the remaining shares in the account. However, the scenario may create additional complexities when determining income-eligible shares for the RDM calculation, and it definitely creates a problem when no shares remain in the account.

Funds will need to review how they may address a situation in which RDM is required on a fully liquidated account due to income-eligibility requirements. They will also need to disclose to investors what would occur under those circumstances. For instance, some working group members are considering estimating the remaining RDM necessary when principal shares are not available and withholding the amount from redemption proceeds.

## Communicating Negative Yield Factors

The working group partnered with DTCC to develop *Communicating Negative Rate & Share Cancellation Activity for CNAV Money Market Funds: Best Practices*.<sup>15</sup> Topics include:

- » Use of the MF Info Xchange “Event Notification” template to create one example of advanced communication of the initial occurrence of negative yield
- » Use of MFPS I for communicating negative yield
- » Use of Networking F55 activity records for funds to communicate RDM transactions to intermediaries for the intermediary’s accounts held by the transfer agent

Members of the RDM Feasibility Working Group noted the importance of communicating negative yield to the marketplace, especially the first time a CNAV money market fund experiences a negative yield. To this end, the group has issued the following recommendations:

### Stand-Alone Initial Notification of Negative Yield

Today, CNAV money market funds use a variety of ways to communicate daily income factors or to announce special fund events, such as mergers and soft closures. The working group recommends that CNAV money market funds adopt a similar announcement strategy for the *initial* passing of negative yield information to counterparties. This often involves the use of email, blast fax, web portals, and other means of disseminating information, and the communication may occur well before the actual daily negative yield factor is known on the business day in question.<sup>16</sup>

The working group recommends that funds use specific language when communicating that a negative yield will be provided for the first time. If the fund *uses MFPS I* to communicate negative yield information, use the following sentence(s) that correspond to the situation:

1. This fund will declare a negative yield for the listed CNAV money market funds.
2. The negative yield daily rates are provided for each affected fund, as well as through the DTCC’s MFPS I price/rate service. *[or]*
3. The negative yield daily rates will be provided through the DTCC’s MFPS I price/rate service as soon as they are available.

If the fund *does not use MFPS I* to communicate negative yield, the following language is recommended. Sentence 1 will always apply. Sentences 2 and 3 may apply individually or together. Funds should adjust the message accordingly:

1. This fund will declare a negative yield for the listed CNAV money market funds.
2. The negative yield daily rates are provided for each affected fund in this communication. *[and/or]*
3. The negative yield daily rates will (also) be provided (by email, by fax, etc.) as soon as they are available.

<sup>15</sup> See [www.dtccllearning.com/documents/mutual-fund-services/money-market/3652-communicating-negative-rate-share-cancellation-activity-for-cnav-money-market-funds-best-practices/file.html](http://www.dtccllearning.com/documents/mutual-fund-services/money-market/3652-communicating-negative-rate-share-cancellation-activity-for-cnav-money-market-funds-best-practices/file.html). A valid login and password must be used to access this information and may be obtained at [www.dtccllearning.com](http://www.dtccllearning.com).

<sup>16</sup> The working group worked with DTCC to leverage the Event Notification template of the MF Info Xchange product to create one example of advanced communication of the initial occurrence of negative yield. Other alternative methods may be used to achieve similar communication results.

## Negative Yield Daily Factor Communication Through MFPS I

Given the additional activities that recordkeepers will need to complete when calculating and applying RDM, it is especially important to disseminate negative yield factors as soon as possible. The working group's recommended practice is to use MFPS I to communicate negative yield factors, especially if the money market fund in question already uses MFPS I to provide positive yield factors. The MFPS I service is familiar to many in the industry, enjoys broad use across multiple constituencies, and provides an integrated, streamlined approach to deliver yield information in a timely fashion.

The DTCC added the ability to pass negative yield factors through the MFPS I service in November 2020.<sup>17</sup> MFPS I supports sending and/or receiving factors in both ISO/SWIFT and non-ISO formats; both were modified for this purpose. Best practices are described in the DTCC's *Communicating Negative Rate & Share Cancellation Activity for CNAV Money Market Funds: Best Practices*.

## Communicating RDM Activity

The RDM life cycle ends once the RDM activity is fully reconciled—between intermediaries and fund, and between the fund's transfer agent and fund accounting. Fund transfer agents and fund accountants are expected to work with their respective service providers to determine how RDM activity from the transfer agent system will be incorporated into the cash and share reporting provided to fund accounting. The working group has developed recommendations to help funds and intermediaries clearly report RDM share cancellation activity between counterparties, as described in the following sections.

### Fund Transactions

To help intermediaries understand the effects of RDM share cancellation transactions on their mutual fund accounts, funds will need to communicate the transactions to intermediaries in a readily identifiable way. Standard industry practice is to use the NSCC Networking service to convey transactions posted to intermediary-controlled accounts on the transfer agent system, such as omnibus, network Level 3, and trust networked Level 0 accounts.<sup>18</sup> The intermediary may use the transactions received to reconcile the fund's books and records with the related activity of its beneficial owners that hold omnibus accounts, for example.

The working group recommends use of the Networking F55 transaction activity record to communicate RDM-related share cancellation activities, as described in the DTCC's *Communicating Negative Rate & Share Cancellation Activity for CNAV Money Market Funds: Best Practices*.

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<sup>17</sup> See DTCC Important Notice [a8917](#) dated October 19, 2020, for information about the enhancement and its anticipated delivery on November 23, 2020. DTCC members may select "record layouts" at <https://dtcclearning.com/products-and-services/mutual-fund-services.html> for additional details.

<sup>18</sup> Most individual accounts opened on fund transfer agent systems through the NSCC by broker-dealers are network Level 3 accounts, and those opened by trust companies are network Level 0 "trust networked" accounts. Accounts are typically opened in the name of the broker-dealer or trust, respectively, on behalf of its customer. As with omnibus accounts, the intermediary handles all communications and servicing of its customer accounts.

## Intermediary Transactions

Some omnibus intermediaries provide transaction details to funds in support of fund oversight and sales reporting needs. Often, the DTCC's Networking Omni/SERV service or proprietary files that leverage similar layouts and capabilities as Omni/SERV are used to facilitate transparency.<sup>19</sup>

Intermediaries that use Omni/SERV files are strongly urged to work with their subaccounting providers, as applicable, to implement consistent codes across intermediaries. This practice will help funds when identifying RDM share cancellation transactions. For instance, the working group found that the inherent flexibility of Omni/SERV allows for existing transaction codes and major/minor broker identification number (BIN) codes within the service. This capability allows intermediaries to separately identify the RDM share cancellation transactions for funds in the file. Regardless of the method used for reporting transactions—Omni/SERV or other proprietary methods—intermediaries will need to communicate to funds how they will represent and report RDM share cancellation transactions, as required.

## Fund and Account Reconciliation

It will be critical for fund accounting, the fund's transfer agent, and intermediaries to reconcile RDM share cancellation activity between parties. The following describes some considerations regarding reconciliation, including the important consideration of breakage between aggregate fund and shareholder account activity, and, for omnibus intermediaries, between aggregate fund omnibus account and beneficial owner account activity.

## Rounding and RDM

While no one can predict the overall size of a daily negative yield factor that will require pro rata distribution through the RDM, it is likely that the factor will be small. When combined with small retail shareholder account balances, it is possible that some shareholders may rarely or never have an RDM transaction posted to their account. The cumulative effects of these accounts may mean that a portion of the RDM that fund accounting expected to be allocated was not actually allocated to customer accounts.

For example, the following table illustrates RDM transactions at five levels of annualized return between -0.10 and -1.00 percent, demonstrating how they may never appear in account balances of a certain size. The values in **bold and italics** represent daily share cancellation transactions that would round to 0.000 shares.

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<sup>19</sup> Omni/SERV® supports the transmission of activity and position information by intermediaries for the beneficial owner accounts that make up the intermediary's omnibus accounts held at the fund. This feature provides important transparency for omnibus relationships.

## EXHIBIT 6

### Hypothetical Effects of RDM on Smaller-Balance Accounts

Annual negative yield	Daily negative accrual	Account balance	Daily share cancellation*	Account balance	Daily share cancellation*	Account balance	Daily share cancellation*
0.0010	0.0000027	\$100.00	<b>0.000</b>	\$500.00	<b>0.001</b>	\$1,000.00	<b>0.003</b>
0.0025	0.0000068	\$100.00	<b>0.001</b>	\$500.00	<b>0.003</b>	\$1,000.00	0.007
0.0050	0.0000137	\$100.00	<b>0.001</b>	\$500.00	0.007	\$1,000.00	0.014
0.0075	0.0000205	\$100.00	<b>0.002</b>	\$500.00	0.010	\$1,000.00	0.021
0.0100	0.0000274	\$100.00	<b>0.003</b>	\$500.00	0.014	\$1,000.00	0.027

\*Any daily share cancellation value less than 0.005 shares will round down to 0.000 since \$1.00 CNAV money market funds transact based on hundredths of a share.

Beyond the small-balance account consideration identified in Exhibit 6, the daily rounding of RDM activity to hundredths of a share (or two decimal places) on accounts may introduce instances of breakage. It is impossible to know the cumulative effect of these rounded transactions on the overall precision of allocation between fund accounting and fund transfer agent, or between intermediary beneficial owner accounts and the related omnibus account at the fund transfer agent. Therefore, daily share cancellation reconciliation will be critically important.

### Fund Complex Reconciliation

Fund accounting will need to reconcile the breakage between what is expected at the fund level versus what is pro rata distributed to accounts at the fund's transfer agent. Transfer agent systems typically provide cash and share reporting to fund accounting for use in reconciliation activities. Fund accounting will need to take into consideration the amount of RDM share cancellation processed on the transfer agent system. It may be necessary to adjust subsequent RDM daily negative yield factors to make sure the correct number of shares get cancelled each day to maintain a constant NAV.

### Omnibus Intermediary Reconciliation

Omnibus intermediaries will need to reconcile the RDM transaction posted to their omnibus account(s) at the fund transfer agent with the separate RDM share cancellation transactions they posted to their beneficial owner accounts on the prior business day. Funds are strongly encouraged to provide the intermediary with the recommended Networking F55 activity transaction to facilitate reconciliation.

As with payment of positive income, the intermediary will be responsible for covering any breakage experienced. It is possible that more shares will be cancelled from the omnibus account than in aggregate from the beneficial owner accounts. This discrepancy occurs because of the larger aggregate balance of the omnibus account compared to each beneficial owner account that makes up its balance.

## Additional Considerations

In addition to the various back-office considerations described in this playbook, discussions are ongoing regarding approaches to clarify shareholder and fund tax reporting, as well as the effects of RDM on fund financial statements delivered to shareholders and filed with the SEC. ICI will provide its members with information about decisions made in these two important areas through its regular memo distribution process.

# Considerations Checklist

## Constant NAV Money Market Fund (CNAV Money Market Fund) Reverse Distribution Mechanism (RDM)

The RDM Feasibility Working Group offers the following checklist for ICI members, intermediaries, and their respective service providers to support RDM on a CNAV money market fund.<sup>20</sup> The checklist assumes that all recommended practices have been or will be adopted.

### LEGAL/ADMINISTRATIVE FOR FUNDS

1. Confirm that the money market fund's state charter permits the use of share cancellation methods to maintain a constant NAV.
2. Update fund documents to permit use of RDM, including incorporation of any required disclosures identified and/or required by federal and/or state regulators.
3. Consider how the fund's Board of Directors may need to be engaged regarding RDM, including initiation/ authorization and ongoing reporting, if ever used.

### SHAREHOLDER COMMUNICATIONS

1. Discuss desired shareholder communication strategies, including print mail, electronic, and telephone communication, to align with business priorities as well as any regulatory guidance received.
2. Implement a shareholder communication strategy. Potential areas of focus may include the following:
  - a. Pre-notification of the possible use of RDM
  - b. Notification that RDM has been applied
  - c. Explaining what RDM is
  - d. Tax implications of RDM, including the reporting of RDM details to shareholders for tax filing purposes
3. Develop scripts for telephone communications with shareholders, financial advisers, intermediary back-offices, and other affected counterparties.
4. Train client-facing staff on RDM.

### INTERMEDIARY COMMUNICATIONS FOR FUNDS

1. Discuss desired intermediary communication strategies, including timing of communication and information to be shared.
2. Determine how the fund may assist intermediaries with information and communication to beneficial owners about RDM.

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<sup>20</sup> The checklist offers suggested areas for consideration and should not be considered all-encompassing.

## FUNCTIONAL CONSIDERATIONS

Understand overall readiness (e.g., internal organization, service provider[s], etc.) to support the various system and process modifications necessary to support RDM.

### 1. Fund accounting

- a. Be able to calculate and disseminate negative yield information.
- b. Ensure access to transfer agent reporting that identifies RDM share cancellation transactions posted to shareholder accounts and knows how to identify those transactions.
- c. Identify the information that must be retained each day for regulatory and audit reporting purposes, especially if specific regulatory guidance regarding RDM is received.
- d. Once guidance is received, make corresponding preparations to address any fund-level taxation requirements for reporting or withholding.

### 2. Recordkeeping

- a. Be able to receive, remit (if necessary), and store daily negative yield factors to support current-day and as-of transaction processing.
- b. If using DTCC MFPS I to send or receive daily yield factors, understand when the capabilities to manage daily negative yield factors through MFPS I will be available. Have alternate delivery method(s) ready until the organization is able to use MFPS I.
- c. Ensure understanding of how RDM processing relates to existing process flows supporting money market funds and other mutual fund products.
- d. Understand the workflow necessary to calculate RDM share cancellation transactions at the shareholder account level, including the level of automation available, reporting for reconciliation purposes, and handling of RDM when a pending full redemption of shares exists.
- e. RDM activity should be mapped to Networking F55 activity records, following industry recommended practice. Intermediaries should be prepared to receive this activity.
- f. RDM activity should be mapped to sales reporting and other omnibus transparency activity following industry recommended practice. Funds should be prepared to receive this activity. Intermediaries should communicate their RDM activity mapping to recipients.
- g. Review how RDM activity will be communicated on shareholder confirmations, on statements, and through web access and integrated voice response, as applicable.
- h. Develop and document processes for RDM activity corrections—either due to as-of activity or error correction.
- i. Identify reporting to be used for reconciliation of RDM share cancellation transaction activity between counterparties (e.g., intermediary and fund) and know how those transactions are identified in the recordkeeping system.
- j. Once guidance is received, make corresponding preparations to address shareholder tax reporting of any RDM share cancellation activity.





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