

# Operating in a Negative Yield Environment

LIQUIDITY | GLOBAL LIQUIDITY TEAM | 2017

The Morgan Stanley Liquidity Funds (MSLF) Euro Liquidity Fund (“the Fund”) is structured to provide investors with two types of share class options:

- Distributing Share Class – Constant Net Asset Value (CNAV)
- Accumulating Share Class – Variable Net Asset Value (VNAV)

While both types of share classes will operate in a negative net yield environment, it is important that shareholders consider how each respective share class’ net asset value (NAV) and the number of shares held could be impacted. Shareholders may find that their investment policies, treasury management operations or accounting policies suggest a preference for a particular share class.

## Summary of Share Class Operation in a Negative Net Yield Environment:

### 1. CONSTANT NAV – DISTRIBUTING SHARE CLASS

Will continue to seek to maintain a constant NAV of €1 in a negative net yield environment as it does in a positive net yield environment. However, in a negative net yield environment, in order for the fund to seek to maintain a constant NAV, the number of shares held by an investor will be reduced on a pro rata basis. This compulsory redemption of shares will occur at the end of each day.

### 2. VARIABLE NAV – ACCUMULATING SHARE CLASS

A negative net yield will be reflected in the NAV which will decrease accordingly. This methodology is the inverse of what would occur in a positive net yield environment in which the NAV increases. In both a positive and negative yield environment the number of shares held by an investor will remain unchanged.

## Transacting With the Fund in a Negative Net Yield Environment:

Regardless of share class, the Fund is designed to accept purchases and redemptions in a negative net yield environment. Transactions will be communicated to the Fund in the same manner as they would be in a positive net yield environment.

## Further Details – How the Euro Distributing Share Class Will Operate in a Negative Net Yield Environment:

Certain key operational elements of this share class will change should the Fund’s net yield be negative.

### HOW WILL THE SHARE CLASS MAINTAIN A CONSTANT €1 NAV?

- The number of shares owned by an investor will decrease each day on a pro rata basis in order to fully offset the impact of the negative net yield. The aggregate proceeds across all investors from this compulsory share redemption mechanism will be retained by the Fund to cover the shortfall due to the portfolio’s negative net yield and result in the Fund maintaining a constant €1 NAV.

**WHEN DOES THE COMPULSORY SHARE REDEMPTION OCCUR?**

- The compulsory redemption occurs on each dealing day and will be reflected as the last transaction of the day. A trade confirmation will be generated daily reflecting the compulsory redemption transaction.

**HOW WILL THE NUMBER OF SHARES TO BE REDUCED BE CALCULATED?**

- The methodology which will be utilized to execute compulsory share redemptions in the net negative yield environment is below.

Number of shares to be redeemed = shareholder units \* dividend factor

- Shareholder units represent the number of shares held by each respective investor. The dividend factor is based on the net loss realized in the Fund and can be found on our website in the daily prices section or on the Daily Rate Report to which investors may choose to subscribe to.

**Example A – Sample account activity**

	SOD Position (units)	Trading Activity (units)	Redemption Proceeds (€)	Post Dealing Position (units)	Dividend Factor	Compulsory Redemption	EOD Position (units)	Net Asset Value (€)
01 December 2014	1,500,000.00	-		1,500,000.00	-0.00000274	-4.11	1,499,995.89	1.00
02 December 2014	1,499,995.89	-		1,499,995.89	-0.00000274	-4.11	1,499,991.78	1.00
03 December 2014	1,499,991.78	Redeem 1,000,000.00	1,000,000.00	499,991.78	-0.00000548	-2.74	499,989.04	1.00
04 December 2014	499,989.04	-		499,989.04	-0.00000548	-2.74	499,986.30	1.00
05 December 2014	499,986.30	-		499,986.30	-0.00000548	-2.74	499,983.56	1.00

**HOW WILL TRANSACTIONS BE PROCESSED?**

- There will be no changes to the normal subscription or redemption process. Both purchases and redemptions will continue to be processed on a daily basis.
- Dealing deadlines will remain the same.

**HOW WILL AN INVESTOR KNOW HOW MANY SHARES ARE AVAILABLE FOR REDEMPTION?**

- An investor can place a call into the client service desk or call the Transfer Agent directly. This information will also be available on their latest trade confirmation, MT535 SWIFT message or by logging on to iFast or Treasury Investment Portal. iFast and Treasury Investment Portal are online tools that allow clients to access their positions and transactions.

**Example B – Trade confirmation****Morgan Stanley****Confirm****Client Mailing Address**

John Smith  
25 Cabot Square  
Canary Wharf  
London E14 4QA

**Client Registered Address**

John Smith  
25 Cabot Square  
Canary Wharf  
London E14 4QA

**Client Name:** John Smith  
**Account Number** 3752

<b>Fund Name</b>	<b>EURO LIQUIDITY FUND</b>	<b>Fund Class</b>	<b>Institutional Shares</b>
<b>ISIN</b>	<b>LU0875333444</b>	<b>CUSIP</b>	<b>L64887208</b>

The Management Company would like to inform you of the following compulsory redemption;

<b>Opening Balance</b>	1,500,000.00
<b>Contract Reference</b>	7947714
<b>Transaction Date</b>	01 - DEC - 2014
<b>Settlement Date</b>	01 - DEC - 2014
<b>Number of Shares</b>	-4.11
<b>Price</b>	1.000000
<b>Consideration</b>	EUR -4.11
<b>Balance of shares Held:</b>	1,499,995.89

Date and time of trade receipt is available upon request.

**HOW WILL THE CHANGE BE REFLECTED ON AN INVESTOR'S STATEMENT?**

- The compulsory redeemed shares will be reflected on your monthly statement (similar to a dividend distribution but with the opposite effect).

**Example C – Investor statement**

# Morgan Stanley

**Client Statement**

**Client Name** John Smith

**Mailing Address** 25 Cabot Square  
Canary Wharf  
London E14 4QA

**Date** 05/12/2014

**Shareholder Name** John Smith

**Registered Address:**

25 Cabot Square  
Canary Wharf  
London E14 4QA

**Umbrella Name:** Morgan Stanley Liquidity Funds

**Account Number** 3752

**Fund Name** EURO LIQUIDITY FUND

**Fund Class** Institutional

**Fund Currency** EUR

**ISIN** LU0875333444

**CUSIP** L64887208

**Statement Period** **From** 01/12/2014 **To** 05/12/2014  
Accrued Income

Trade Date	Transaction	Deal Price	Shares	Amount	Share Balance	Income	Market Value
01/12/2014	Opening Balance	1.00			1,500,000.00		1,500,000.00
01/12/2014	Income Compulsory					-4.11	
01/12/2014	Redemption	1.00	-4.11	-4.11	1,499,995.89		1,499,995.89
02/12/2014	Income Compulsory					-4.11	
02/12/2014	Redemption	1.00	-4.11	-4.11			1,499,991.78
03/12/2014	Redemption	1.00	-1,000,000.00	-1,000,000.00	499,991.78		499,991.78
03/12/2014	Income Compulsory					-2.74	
03/12/2014	Redemption	1.00	-2.74	-2.74	499,989.04		499,989.04
04/12/2014	Income Compulsory					-2.74	
04/12/2014	Redemption	1.00	-2.74	-2.74	499,986.30		499,986.30
05/12/2014	Income Compulsory					-2.74	
05/12/2014	Redemption	1.00	-2.74	-2.74	499,983.56		499,983.56
05/12/2014	Closing Balance	1.00			499,983.56		499,983.56

**WILL DIVIDENDS BE PAID?**

- A dividend will not be paid as there is no positive income to distribute. Dividends will recommence when the Fund's net yield turns positive.

**WILL THE FUND CONTINUE TO PROVIDE DAILY RATES?**

- Yes, the Fund will continue to produce daily rate information which will include the negative daily rate and negative income factor. Additionally, weekly and monthly holdings and disclosures of the daily and weekly liquidity will continue to be provided.

**WILL THE FUND STILL CHARGE A MANAGEMENT FEE?**

- Yes, the fund may still charge a management fee.

**HOW CAN AN INVESTOR SWITCH BETWEEN SHARE CLASSES?**

- There will be no change in how a switch between share classes is handled. A redemption from the existing share class is placed followed by a purchase into the new share class where an equivalent amount of shares are purchased.

**If you have further questions or require additional assistance, please contact your Morgan Stanley Relationship Manager.**

**THE CURRENT NET NEGATIVE YIELD RETURN: Please be advised that as of 6 May 2015, the Euro Liquidity Fund, a sub-fund of Morgan Stanley Liquidity Funds, began returning a negative net yield. In accordance with the fund's procedures for operating in a net negative yield environment, which are noted in the fund's prospectus, the distributing share class of the fund will reduce the number of shares held by shareholders on pro rata basis each day in order for the fund to seek to maintain a constant net asset value.**

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#### **DEFINITIONS:**

**NAV** is the Net Asset Value per share of the Fund (NAV), which represents the value of the assets of a fund less its liabilities.

**Dealing Deadline** - the cut-off time for the applications for subscription, exchange or redemption of Shares in a Fund, as specified in "Fund Particulars."

**Yields** are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

#### **IMPORTANT INFORMATION**

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