Variable-rate demand notes (VRDNs) have historically been a core holding in municipal money market funds because of their effectiveness as a tool for managing a fund’s liquidity and average maturity. The relative safety and soundness of the VRDN structure has been demonstrated through various market conditions and economic cycles, most notably during the 2008 financial crisis. In recent years, VRDNs have become a popular investment alternative for prime money market funds due to their ability to provide liquidity and enhance principal preservation.

What are VRDNs?
VRDNs are longer-term municipal securities that feature both a periodic coupon reset and a demand feature that allows an investor to periodically tender, or put, the securities at par plus accrued interest.

Periodic coupon resets. The interest rate on VRDNs is generally reset daily or weekly based on the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index. This reset feature ensures that VRDN yields reflect the current interest-rate environment.

Demand feature. VRDNs also generally have a one-day or seven-day demand feature, or put option, which enables an investor to tender the securities to a financial intermediary—such as a remarketing agent, tender agent, or trustee—after providing a one-day or seven-day notification. This feature allows VRDNs to be considered under U.S. Securities and Exchange Commission (SEC) Rule 2a-7 as having a maturity equal to the next put date rather than its final maturity date.

Credit and liquidity enhancement. Virtually all VRDNs benefit from third-party credit and liquidity enhancements, ensuring payment of principal and interest on tendered securities. The main types of credit enhancement include letters of credit and standby bond purchase agreements, both of which are typically provided by a highly rated bank or other financial institution. Letters of credit offer a somewhat higher degree of security as they obligate the credit provider to pay principal and interest to bondholders within a certain time frame if the underlying issuer is unable to fulfill its obligation.

Key features make VRDNs attractive for money market funds
There are four features that make VRDNs a desirable investment for money market funds:

- Eligible securities under SEC Rule 2a-7
- Highly liquid with a stable value
- Short term to repayment
- High credit quality

SEC Rule 2a-7 requires a money market fund to maintain at least 30% of its total assets in weekly liquid assets, which includes “securities that mature or are subject to a demand feature that is exercisable and payable within five business days.” The demand feature not only ensures liquidity but also promises repayment at par, which means the value of a VRDN remains stable. Further, VRDNs used in our money market funds are analyzed by our credit specialists to determine that they present minimal credit risk.
Market overview

The VRDN market is approximately $224 billion in size and is composed of more than 10,000 individual securities.¹ The vast majority of issuers are public entities. As shown in Chart 1 below, the amount of VRDNs outstanding increased in 2008 as failed auction-rate securities were repackaged as VRDNs. More recently, outstandings have declined as issuers have sold long-term bonds in order to lock in historically low interest rates. Additionally, many issuers have continued to have an austerity mindset several years post the Great Recession, which has resulted in only modest amounts of new issuance across both short- and long-term municipal supply.

Chart 1 | The VRDN market has returned to its precrisis size

![Chart 1](image)

Source: Thomson Reuters (TM3)
Past performance is no guarantee of future results.

As the Federal Reserve has continued an accommodative monetary policy, all interest rates have fallen, including yields on VRDNs. However, nontraditional buyers have remained attracted to VRDNs due to the principal stability and liquidity features inherent in VRDNs.

Chart 2 | While VRDN yields remain at near record lows, they provide a defensive strategy against higher interest rates

![Chart 2](image)

Source: Bloomberg
Past performance is no guarantee of future results.

Pricing remains extremely stable because VRDNs can be put back at par on a daily or weekly basis. However, investors can expect differences in the yield offered on specific issues. Relative supply and demand for an issue will vary based on many factors, such as rates in other related sectors (for example, commercial paper and government repurchase agreements). Other factors include the relative credit quality of the liquidity or credit support provider, whether the issue is subject to state taxes or the Alternative Minimum Tax or is fully taxable, and dealer inventory levels.

VRDNs and Wells Fargo Money Market Funds

Prior to the purchase of any security in one of our money market funds, our team of credit analysts conducts a thorough analysis of its credit quality, including the underlying issuer, the terms and conditions of any credit or liquidity enhancement, and the credit quality of any provider of enhancement. In the VRDN sector, this analysis is performed by our dedicated team of municipal credit specialists. Only after a determination is made that a security presents minimal credit risk can it be added into one of our money market funds.

---

¹ The SIFMA Municipal SWAP Index is a seven-day high-grade market index composed of tax-exempt VRDO reset rates that are reported to the Municipal Securities Rulemaking Board’s SHORT reporting system. You cannot invest directly in an index.

VRDNs are debt securities commonly held within the Wells Fargo Money Market funds. Like all bonds, VRDN values fluctuate in response to the financial condition of individual issuers, general market and economic conditions, and changes in interest rates. Changes in market conditions and government policies may lead to periods of heightened volatility in the bond market and reduced liquidity for certain bonds. In general, when interest rates rise, bond values fall and investors may lose principal value. Interest-rate changes can be sudden and unpredictable. In addition to credit and interest-rate risk, VRDNs are subject to municipal securities risk.

You could lose money by investing in a money market fund. Funds that seek to preserve the value of your investment at $1.00 per share cannot guarantee to do so. Because the share price of some funds may fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. Some money market funds may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the fund’s liquidity falls below required minimums because of market conditions or other factors. An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. A fund’s sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.

Carefully consider a fund’s investment objectives, risks, charges, and expenses before investing. For a current prospectus and, if available, a summary prospectus, containing this and other information, visit wellsfargofunds.com.

Wells Fargo Asset Management (WFAM) is a trade name used by the asset management businesses of Wells Fargo & Company. Wells Fargo Funds Management, LLC, a wholly owned subsidiary of Wells Fargo & Company, provides investment advisory and administrative services for Wells Fargo Funds. Other affiliates of Wells Fargo & Company provide subadvisory and other services for the funds. The funds are distributed by Wells Fargo Funds Distributor, LLC, Member FINRA, an affiliate of Wells Fargo & Company. Neither Wells Fargo Funds Management nor Wells Fargo Funds Distributor has fund customer accounts/assets, and neither provides investment advice/recommendations or acts as an investment advice fiduciary to any investor. 301476 03-17