

Amendments to the Regulatory Structure Governing Money Market Funds

Introduction

The Securities and Exchange Commission ("SEC") adopted on February 23, 2010 amendments to Rule 2a-7 and other rules under the Investment Company Act of 1940 ("1940 Act") governing the regulation of money market mutual funds ("money funds").¹ The amendments were proposed on June 30, 2009² and approved, with several changes, at an open meeting held on January 27, 2010. The amendments are intended to: (i) strengthen Rule 2a-7's risk-limiting conditions, including the addition of a new liquidity requirement; (ii) enhance portfolio information disclosure; and (iii) improve fund operations.

Background

As the credit boom of the last decade began to unwind in 2007, a global financial crisis ensued that, among other things, effectively caused the secondary market for many structured investment vehicles ("SIVs") that were tied to sub-prime mortgage assets to cease to exist, except at distressed prices. As a result, investments in SIVs threatened to seriously impact the ability of many money funds to maintain a stable \$1.00 share price. The SEC staff provided

no-action relief to affiliate purchasers during the early stages of the crisis, permitting fund affiliates to support the stable NAVs of the funds through the use of various arrangements.³

The global financial credit crisis deepened in 2008 after Lehman Brothers Holdings Inc. ("Lehman Brothers") filed for Chapter 11 bankruptcy protection on September 15, 2008. The next day, The Reserve Primary Fund ("Reserve"), which had held a \$785 million position in Lehman Brothers debt, became the second money fund in history to break the dollar.⁴ In the days after Reserve broke the dollar, there was a run on prime money funds, with nearly \$300 billion being withdrawn from those funds as a result of a "flight to quality."⁵ These extraordinary redemption requests impaired the ability of many prime money funds

¹ See Money Market Fund Reform, SEC Release No. IC-29132 (Feb. 23, 2010) [75 Fed. Reg. 10,060 (Mar. 4, 2010)] ("Adopting Release"). The SEC adopted: (i) amendments to Rules 2a-7 and 17a-9 and temporary Rule 30b1-6T; (ii) new Rules 22e-3 and 30b1-7; and (iii) new Form N-MFP (collectively, "amendments"). The amendments become effective May 5, 2010, although compliance with portions of the amendments and rules is required as of later dates, as spelled out in the Adopting Release and discussed in this *DechertOnPoint*.

² See Money Market Fund Reform, SEC Release No. IC-28807 (June 30, 2009) [74 Fed. Reg. 32,688 (July 8, 2009)] ("Proposing Release").

³ For example, the SEC had provided no-action relief to permit affiliate purchases of fund portfolio securities that remained "Eligible Securities" under Rule 2a-7 but had become less liquid investments.

⁴ "Breaking the dollar" colloquially refers to the market-based net asset value ("NAV") per share of a money fund falling below the fund's stable share price (typically \$1.00). Unlike other firms, The Reserve Fund group was unable to secure credit support in time to meet significant demands for redemption. Illiquidity in the credit markets prevented its investment adviser from disposing of portfolio securities without impairing the share prices of its money funds. Faced with these circumstances, Reserve applied to the SEC for, and received, orders permitting several of its money funds to suspend redemptions. See, e.g., *In re* The Reserve Fund (File No. 812-13576), and SEC Release No. IC-28386 (Sept. 22, 2008) [73 Fed. Reg. 55,572 (Sept. 25, 2008)] (order).

⁵ See Adopting Release, *supra* note 1, at p. 6.

to provide liquidity to redeeming investors through ordinary means.⁶

During this period, the SEC staff provided no-action relief allowing asset purchase and credit support arrangements to be implemented by money funds facing credit or liquidity challenges. The Department of the Treasury (“Treasury”) and the Federal Reserve Board also implemented several programs in an effort to improve market liquidity and assist money funds.⁷

The severity of the problems experienced by money funds during 2007 and 2008 prompted the SEC to consider money fund regulation reform and, ultimately, to adopt the amendments discussed below.

Discussion

Changes to Rule 2a-7’s Risk-Limiting Conditions⁸

Rule 2a-7 currently imposes three categories of risk-limiting conditions that govern the composition of a money fund’s portfolio: quality, maturity and diversification. In addition to tightening the Rule’s risk-limiting conditions, the amendments introduce a new category of risk-limiting conditions that govern the liquidity of a money fund’s portfolio.

Portfolio Quality

Investments in Second Tier Securities

Rule 2a-7 currently limits the portfolio holdings of money funds to securities that are “Eligible Securities” as defined in the Rule. Eligible Securities are generally short-term securities that, at the time of acquisition, are rated in one of the top two short-term debt ratings by

⁶ While some funds held debt securities issued by Lehman Brothers, others did not. The liquidity difficulties encompassed many types of short-term securities and were not limited to Lehman paper.

⁷ The Treasury announced the “Temporary Guarantee Program for Money Funds” in September 2008 (expired in September 2009). The Federal Reserve announced the “Money Market Investor Funding Facility” in October 2008 (expired in October 2009). The Federal Reserve also announced the “Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility” in September 2008 and the “Commercial Paper Funding Facility” in October 2008 (each expired on February 1, 2010).

⁸ The compliance date for the amendments discussed in this section is May 28, 2010, except as otherwise indicated.

the requisite nationally recognized statistical rating organizations (“NRSROs”) or, if unrated, have been deemed to be of comparable quality to such securities.⁹ Eligible Securities are further divided into “First Tier Securities” and “Second Tier Securities.”¹⁰

The amendments, as proposed, effectively would have limited money fund investments to First Tier Securities by removing Second Tier Securities from the definition of Eligible Securities. As adopted, the amendments continue to permit money fund investments in Second Tier Securities, but add several restrictions, to:

(i) reduce the percentage of assets that a money fund is permitted to invest in Second Tier Securities from 5% to 3% of the fund’s total assets;¹¹ (ii) limit a money fund’s exposure to any single Second Tier issuer to 0.5% of the fund’s total assets (instead of the current limit of the greater of 1% of the fund’s assets or \$1 million);¹² (iii) shorten the maximum remaining maturity of any Second Tier Security acquired by the fund to 45 days (from the 397 days permitted currently); and (iv) reduce from 5% to 2.5% the percentage of a fund’s assets that can be invested in securities subject to Second Tier Demand Features or Guarantees.¹³

Designation of NRSROs

The amendments impose several new requirements on a money fund’s Board of Directors with respect to the fund’s reliance on NRSROs: (i) the Board must designate at least four NRSROs (“Designated NRSROs”) on whose short-term credit ratings the fund will rely when

⁹ Determining whether a security is an “Eligible Security” under Rule 2a-7 involves different considerations for rated and unrated securities, and for securities that are subject to guarantees and demand features.

¹⁰ A “First Tier Security” is any Eligible Security that has received the highest short-term debt rating from any two NRSROs (or an unrated security of comparable quality), a security that is issued by another registered money fund, or a “Government Security” (as defined in Rule 2a-7). A “Second Tier Security” is any Eligible Security that does not qualify as a First Tier Security.

¹¹ See amended Rule 2a-7(c)(3)(ii). This limitation applies to all money funds. In comparison, Rule 2a-7 currently limits Second Tier investments by tax-exempt funds only with respect to conduit securities. See Rules 2a-7(c)(3)(ii)(A) and (B).

¹² See amended Rule 2a-7(c)(4)(i)(C).

¹³ See amended Rule 2a-7(c)(3)(ii). For historical context, it should be noted that, immediately prior to the Lehman Brothers bankruptcy, Lehman paper qualified as First Tier Securities.

determining whether a security is an Eligible Security for purposes of Rule 2a-7;¹⁴ and (ii) the Board must determine at least once each calendar year that the Designated NRSROs issue credit ratings that are sufficiently reliable for use by the fund. In addition, the money fund must disclose the Designated NRSROs, including any limitations on the use of such designation,¹⁵ in the fund's statement of additional information ("SAI").¹⁶ These new requirements are intended to, among other things, foster competition among existing NRSROs and encourage more NRSROs to enter the credit rating market.¹⁷

In the Adopting Release, the SEC indicated that a Board's actions relating to NRSROs would be based on recommendations of the fund's adviser and its credit analysts, as well as on any information provided by the NRSRO. The SEC stated that it would expect the adviser's annual evaluation of an NRSRO to be based on an examination of the methodology the NRSRO uses to rate securities, including the risks they measure and the NRSRO's record with respect to the types of securities in which the fund invests, including asset backed securities. The SEC specifically recognized that, even with the recommendation of the adviser, the Board's determination whether an NRSRO's ratings are "sufficiently reliable" for use by the Fund will be a matter of judgment.¹⁸

In the Adopting Release, the SEC cautioned against over-reliance on NRSRO ratings, emphasizing that Rule 2a-7 continues to require money fund Boards (typically this responsibility is delegated to the fund's adviser) to determine that portfolio investments "present minimal credit risks, which determination must be based on factors pertaining to credit quality *in addition to* any rating assigned to such securities by an NRSRO."¹⁹

¹⁴ See new Rule 2a-7(a)(11).

¹⁵ A Board may designate an NRSRO only with respect to certain types of securities or certain industries.

¹⁶ The compliance date for the new requirements relating to the designation of NRSROs is December 31, 2010.

¹⁷ See Adopting Release, *supra* note 1, at section II.A.2.

¹⁸ See Adopting Release, *supra* note 1, at n. 111 and accompanying text.

¹⁹ Emphasis added. See Rule 2a-7(c)(3)(i).

Unrated Asset Backed Securities

Rule 2a-7 currently requires most asset backed securities ("ABSs") to be rated by at least one NRSRO in order to be an Eligible Security that a money fund may acquire.²⁰ The amendments eliminate this requirement, permitting money funds to acquire unrated ABSs.²¹ The SEC cautioned, however, that as part of the minimal credit risk analysis required by the Rule, the Board or adviser should continue to: analyze the underlying ABS assets to ensure that they are properly valued and will provide adequate asset coverage for the cash flows required to fund the ABS under various market conditions; analyze the terms of any liquidity or other support provided by the sponsor of the ABS; and otherwise perform the legal, structural, and credit analyses required to determine that the particular ABS presents appropriate risks for the money fund.²²

Maturity of Portfolio Investments²³

Rule 2a-7 currently requires money funds to maintain a dollar-weighted average portfolio maturity that is appropriate to the objective of maintaining a stable NAV per share, subject to a maximum dollar-weighted average portfolio maturity of 90 days. In addition, money funds may not acquire instruments that have remaining maturities of greater than 397 calendar days.²⁴

Weighted Average Maturity

The amendments shorten the maximum dollar-weighted average portfolio maturity ("WAM") of a money fund's portfolio to 60 calendar days (from the current limit of 90 calendar days). The shortened maximum WAM is

²⁰ See Rule 2a-7(a)(10)(ii)(B). The SEC had imposed this requirement in 1996 in part to facilitate the minimal credit risk analysis of fund advisers. See Adopting Release, *supra* note 1, at section II.A.3.

²¹ Pointing to the rapid downgrading of ABS ratings by NRSROs during the 2007-2008 credit crisis, the SEC stated that NRSROs do not play a strong enough role in buttressing the minimal credit risk analysis to justify this requirement. See Adopting Release, *supra* note 1, at text following n. 125.

²² See Adopting Release, *supra* note 1, at n. 131 and accompanying text.

²³ See amended Rules 2a-7(c)(2)(ii)-(iii).

²⁴ Currently, money funds that use the penny-rounding method of pricing can acquire government securities with a remaining maturity of up to 762 calendar days.

intended to reduce the likelihood that a money fund would break the dollar, by further decreasing a fund's exposure to risks related to longer term investments, such as higher levels of price volatility, interest rate risk, liquidity risk, and wider credit spreads. Fund portfolios must comply with this new maximum WAM limit no later than June 30, 2010.

Weighted Average Life

The amendments add a new requirement under Rule 2a-7 that limits the dollar-weighted average life to maturity ("WAL") of money fund investments to 120 calendar days, the calculation of which must be made without regard to a security's interest rate reset dates. This new requirement is intended to limit the credit spread risk associated with longer term adjustable rate securities, particularly in volatile markets, by focusing on the date on which a fund has a legal right to receive the principal amount of each instrument, whether through an instrument maturing or by exercising a demand feature.²⁵ The SEC stated that a 120-day WAL strikes the correct balance between not significantly constraining the range of high quality, short-term debt securities in which money funds may invest, and providing an appropriate amount of spread risk protection to money funds and their investors. Fund portfolios must comply with this new maximum WAL requirement no later than June 30, 2010.

Maturity Limit for Government Securities

The amendments remove the provision from Rule 2a-7 that permits money funds relying exclusively on the penny-rounding method of pricing to acquire government securities with remaining maturities of up to 762 calendar days. Going forward, these securities will be subject to the same 397-day maximum maturity as other First Tier money fund investments.

Diversification: Treatment of Repurchase Agreements

When a money fund enters into a repurchase agreement, the fund may "look through" the repurchase agreement for purposes of Rule 2a-7's diversification calculations (i.e., the securities underlying the repurchase agreement may be considered to be held directly by the fund), provided the repurchase agreement is "collateralized fully." Current Rule 2a-7 defines "collateralized fully" by reference to Rule 5b-3(c)(1) under the 1940 Act, with the result that a money fund could look through any repurchase agreement where the collateral

consists entirely of: (i) cash items; (ii) government securities; (iii) securities that, at the time the repurchase agreement is entered into, are rated in the highest rating category by the requisite NRSROs; or (iv) unrated securities that are of comparable quality to securities that are rated in the highest rating category by the requisite NRSROs, as determined by the money fund's Board or adviser.

The amendments modify this standard by further restricting the types of collateral that will permit a look through with respect to a repurchase agreement. Under the amended Rule, only collateral that meets the first or second prong above (i.e., collateral that consists of cash items or government securities) will qualify a repurchase agreement for look through treatment. In addition, in order for a money fund to rely on the look through provision, the fund's Board (or its delegate) must have evaluated the creditworthiness of the repurchase agreement counterparty.²⁶ These amendments are intended to reduce the risk that a money fund would incur losses when protecting its interests in collateral following a counterparty's default.²⁷

New Liquidity Requirements

Currently, money funds are limited, under a long-standing SEC interpretive position, to investing no more than 10% of their assets in illiquid securities.²⁸ The amendments impose three new liquidity requirements that are intended to increase the likelihood that a money fund will be able to meet a heavy volume of

²⁶ See amended Rule 2a-7(c)(4)(ii)(A). The SEC had eliminated a similar requirement applicable to all repurchase agreements entered into by mutual funds in 2001, in light of amendments to relevant bankruptcy laws. See Treatment of Repurchase Agreements and Refunded Securities as an Acquisition of the Underlying Securities, SEC Release No. IC-25058 (July 5, 2001) [66 Fed. Reg. 36,156 (July 11, 2001)], at nn. 18-20 and accompanying text. The SEC had originally added the evaluation requirement to Rule 2a-7 in 1991 when diversification requirements were added to the Rule. See Revisions to Rules Regulating Money Market Funds, SEC Release No. IC-18005 (Feb. 20, 1991) [56 Fed. Reg. 8113 (Feb. 27, 1991)]. Prior to that time, fund Boards were required to evaluate the creditworthiness of counterparties under SEC Release IC-13005 (Feb. 2, 1983).

²⁷ See Adopting Release, *supra* note 1, at section II.D.

²⁸ See Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145, SEC Release No. IC-17452 (Apr. 23, 1990).

²⁵ See Adopting Release, *supra* note 1, at section II.B.2.

redemptions during times of market turmoil without having to sell securities into a declining market.²⁹

General Liquidity Requirement

The amendments require a money fund to hold securities that are sufficiently liquid to meet reasonably foreseeable redemptions,³⁰ in light of the fund's obligations under Section 22(e) of the 1940 Act³¹ and any commitments made to fund shareholders.³² To comply with this requirement, the SEC expects money funds to adopt policies and procedures designed to assure that appropriate efforts are undertaken to identify the risk characteristics of shareholders.³³ In the Adopting Release, the SEC did not identify specific characteristics that should be addressed in the policies and procedures, although the SEC stated that it expects fund management and Boards to consider such factors as whether shareholders have recurring liquidity needs, the concentration of the fund's shareholder base, and whether the liquidity needs of shareholders coincide.³⁴ These and other factors that affect a money fund's liquidity needs should be taken into account in determining and monitoring those needs. The SEC also stated that:

In their consideration of these procedures and in the oversight of their implementation, fund boards should appreciate that, in some cases, fund managers' interests in attracting additional fund assets may be in conflict with their overall duty to manage the fund in a manner consistent with maintaining a stable net asset value. We urge directors to consider

²⁹ See Adopting Release, *supra* note 1, at section II.C.

³⁰ See new Rule 2a-7(c)(5). The SEC explained that this general mandate may require money funds to maintain greater liquidity than what is required by the new daily and weekly liquidity minimums, which are discussed below.

³¹ Section 22(e) restricts the ability of any fund to delay payment on redeemed shares for more than seven calendar days.

³² Many money funds commit in their prospectuses to paying redemptions on the same day that a redemption request is received or on the next business day following such receipt.

³³ The SEC explained that the amendments do not incorporate this requirement into Rule 2a-7, but noted its belief that such procedures will be required by Rule 38a-1 under the 1940 Act. See Adopting Release, *supra* note 1, at n. 198.

³⁴ See Adopting Release, *supra* note 1, at text accompanying nn. 196-197.

the need for establishing guidelines that address this conflict.³⁵

Overall Limitation on the Acquisition of Illiquid Securities

The amendments prohibit a money fund from acquiring an illiquid security if, immediately after the acquisition, the fund would have invested more than 5% of its total assets in illiquid securities.³⁶ The amendments define "illiquid security" as any security that cannot be sold or disposed of in the ordinary course of business within seven calendar days at *approximately* the value ascribed to it by the fund.³⁷

Minimum Daily and Weekly Liquidity Requirements

The amendments require that, at a minimum, immediately after the acquisition of any security: (i) a *taxable money fund* must have invested at least 10% of its total assets in cash, U.S. Treasury securities, and securities convertible into cash in one business day;³⁸ and (ii) *all money funds* must have invested at least 30% of total assets in cash, U.S. Treasury securities, agency discount notes with remaining maturities of 60 days or less,³⁹ and securities convertible into cash within five business days.⁴⁰ The amendments are intended to

³⁵ See Adopting Release, *supra* note 1, at text accompanying n. 199.

³⁶ See new Rule 2a-7(c)(5)(i). By comparison, the proposed amendments would have prohibited money funds from acquiring any illiquid securities.

³⁷ Emphasis added. See new Rule 2a-7(a)(19). "Approximately" signals that a security would not be deemed to be illiquid simply because it could not be sold at amortized cost. See Adopting Release, *supra* note 1, at text accompanying n. 210. If a security could be sold at approximately the market-based value used to shadow price the security, it could be treated as a liquid security. See Adopting Release, *supra* note 1, at n. 210.

³⁸ See new Rule 2a-7(a)(8).

³⁹ Agency discount notes are government securities issued at a discount to the principal amount to be repaid at maturity. See new Rule 2a-7(a)(32)(iii).

⁴⁰ See new Rules 2a-7(a)(32) and 2a-7(c)(5)(ii)-(iii). Demand deposits are included under cash, and repurchase agreements are included under securities convertible into cash in one or five business days, as applicable. The SEC excluded tax-exempt money funds from daily liquidity requirements, explaining that tax-exempt securities markets are different from other securities markets (e.g., there is a limited supply of tax-exempt securities that have daily demand features). See Adopting Release, *supra* note 1, at n. 243 and accompanying text.

facilitate the ability of money funds to satisfy redemption requests during times of market turmoil.

The amendments differ substantially from those originally proposed by the SEC, which would have required a money fund's Board to determine at least annually whether the fund is an "institutional fund" (e.g., among other things, based on such factors as the fund's minimum initial investment requirements), and would have imposed higher liquidity requirements on institutional funds (10% daily liquid assets and 30% weekly liquid assets) as compared to retail funds (5% daily liquid assets and 15% weekly liquid assets), on the basis that institutional funds can be subject to substantially larger redemption requests.⁴¹ As adopted, the amendments do not distinguish between institutional and retail funds, but rather impose the same daily and weekly minimum liquidity requirements on both types of funds, in recognition of the inherent difficulties in distinguishing between institutional and retail money funds.⁴²

Stress Testing of Portfolios⁴³

The amendments require the Board of a money fund to adopt procedures that provide for the periodic "stress testing" of the fund's ability to maintain its stable NAV per share upon the occurrence of certain hypothetical events, including but not limited to: changes in short-term interest rates; increases in shareholder redemptions; and downgrades of, or defaults on, portfolio securities.⁴⁴ The amendments require stress testing to be conducted at such intervals as the Board determines is appropriate and reasonable in light of current market conditions.

The results of each "stress test" must be reported to the fund's Board at its next regularly scheduled meeting (or sooner, if appropriate in light of the results). The report

⁴¹ See Proposing Release, *supra* note 2, at nn. 218-227 and accompanying text.

⁴² See Adopting Release, *supra* note 1, at n. 227 and accompanying text.

⁴³ The stress testing requirement was based on a proposal described in the Investment Company Institute's money fund report. See ICI, "Report of the Money Market Working Group" (Mar. 17, 2009), available at www.ici.org/pdf/ppr_09_mmmwg.pdf.

⁴⁴ See new Rule 2a-7(c)(10)(v)(A). While the Board is required to *adopt* the stress testing procedures, the SEC specifically notes that the Board is not required to *design* the portfolio stress testing. See Adopting Release, *supra* note 1, at text accompanying n. 264.

must include: the date(s) on which the testing was performed; the magnitude of hypothetical events that would cause the fund to break the dollar; and an assessment by the fund's adviser of the fund's ability to withstand events that are reasonably likely to occur within the following year.⁴⁵

Disclosure of Portfolio Information

The amendments require the disclosure of fund portfolio information in public website postings and in reports filed with the SEC.

Monthly Public Website Posting⁴⁶

Money funds are currently required to disclose their portfolio holdings to the SEC on a quarterly basis (within 60 days after the end of the quarter). While some fund groups currently post portfolio information on their websites, that disclosure is made on a purely voluntary basis. The amendments require each money fund to post information about its portfolio holdings on a public website on a monthly basis no later than five business days after month's end. This posted information must remain accessible on the website for at least six months after posting. The amendments are intended to provide greater transparency to investors regarding the risks to which money funds are exposed.

The amendments require the WAM and WAL of each money fund to be posted on the website. With respect to each security held by the money fund, the amendments specify certain information that must be posted on the website, including, for each portfolio security: the issuer's name; category of investment (e.g., Treasury debt; commercial paper); CUSIP number; principal amount; maturity date; final legal maturity; coupon or yield; and amortized cost value. In addition, the amendments require that the fund's website contain a link to an SEC website where the most recent twelve months of publicly available information filed by the fund may be obtained. Funds must comply with the new public website posting requirement no later than October 7, 2010.

⁴⁵ See new Rule 2a-7(c)(10)(v)(B). Money funds must maintain records of the stress tests for six years, the first two years in an easily accessible place. See amended Rule 2a-7(c)(11)(vii).

⁴⁶ See new Rule 2a-7(c)(12).

Monthly Reporting to the SEC

In the Proposing Release, the SEC noted that information disclosed by a money fund to the SEC on a quarterly basis quickly becomes stale and thus limits the SEC's ability to respond to current market events. Further, the SEC stated that, because the quarterly reports are not required to be submitted in an easily searchable format, the SEC has been unable to closely monitor individual money funds and the money fund industry in general (e.g., the SEC was unable to quickly determine which money funds held SIVs or Lehman paper during the recent credit crisis).⁴⁷

The SEC had adopted temporary Rule 30b1-6T in September 2009 in order to require any money fund that has a market-based NAV per share lower than \$0.9975 on any business day ("Report Date") to, no later than the next business day, notify the SEC that its NAV was less than \$0.9975 and provide the SEC with a portfolio schedule as of the Report Date. Until the fund's market-based NAV per share is \$0.9975 or greater, the fund must provide to the SEC a portfolio schedule as of the last business day of each week, no later than the second business day of the following week.⁴⁸

New Rule 30b1-7 requires all money funds to electronically report to the SEC on new Form N-MFP (in an XML-tagged data format), within five business days after month's end, detailed portfolio holdings information. Under this new requirement, a fund will have to file, with respect to each portfolio security held on the last business day of the prior month: issuer's name; issue's title; CUSIP number; category of investment (e.g., Treasury debt; commercial paper; repurchase agreement);⁴⁹ the fund's Designated NRSROs and the credit ratings given by them; whether each security is First Tier, Second Tier, unrated, or no longer eligible; maturity date; final legal maturity; information regarding enhancement features; principal amount; current amortized cost; percentage of fund assets invested in the security; whether the security is illiquid; total

⁴⁷ See Proposing Release, *supra* note 2, at section II.F.2.

⁴⁸ See Adopting Release, *supra* note 1, at nn. 345-349 and accompanying text.

⁴⁹ See Adopting Release, *supra* note 1, at n. 307 (stating that money funds must provide additional information regarding the collateral underlying a repurchase agreement, under Item 32 of new Form N-MFP).

market-based value; and explanatory notes regarding miscellaneous information.⁵⁰

Money funds also must report their market-based NAVs per share on the new form.⁵¹ However, in response to concerns expressed by many commenters, the amendments delay the public availability of Form N-MFP until 60 days after the end of the month to which the information pertains.⁵²

Because the information required to be filed on Form N-MFP pursuant to new Rule 30b1-7 includes all information that funds with lower market-based NAVs must provide to the SEC under temporary Rule 30b1-6T, the amendments phase out Rule 30b1-6T and extend its expiration date to December 1, 2010.⁵³

Funds must begin to file information on Form N-MFP no later than December 7, 2010. Funds may file trial data on a voluntary basis as early as October 7, 2010.⁵⁴

Other Amendments

Processing of Transactions

The amendments require money funds (or their transfer agents) to have the operational capacity to process shareholder purchase and redemption transactions electronically at a price based on the fund's current market-based NAV per share (i.e., not merely at the fund's stable NAV or price per share).⁵⁵ Funds must

⁵⁰ See Adopting Release, *supra* note 1, at section II.E.2.

⁵¹ The market-based NAV per share must be reported separately for values that take into account capital support agreements and those that do not.

⁵² The SEC anticipates that the public disclosure of monthly market-based NAVs will cause funds to take steps to resolve issues that may raise concerns with investors and analysts. See Adopting Release, *supra* note 1, at text following n. 337.

⁵³ An expiration date of December 1, 2010 for temporary Rule 30b1-6T means that November 30, 2010 will be the last date that funds will be required to file information under that Rule.

⁵⁴ The SEC does not intend to make these voluntary filings available to the public.

⁵⁵ See new Rule 2a-7(c)(13). The SEC noted that the inability of money funds to price shares in accordance with market values potentially exposes shareholders to unnecessary risks, such as the risk that a fund may not meet its obligation to process redemption requests within seven days. See Proposing Release, *supra* note 2, at section II.G.

have this ability in place no later than October 31, 2011.

Purchases by Affiliates

Currently, Rule 17a-9 under the 1940 Act provides an exemption to permit certain affiliates of a money fund to purchase a portfolio security from the fund only if that security has ceased to be an Eligible Security under Rule 2a-7. During the recent crisis, many fund groups obtained no-action relief from the SEC staff to permit the purchase of securities that remained “Eligible Securities,” but which nevertheless had become difficult to sell in the market.

As amended, Rule 17a-9 permits affiliates to purchase distressed securities (e.g., Eligible Securities that have defaulted), as well as other portfolio securities (e.g., non-defaulted Eligible Securities) from affiliated money funds, provided that the purchase price is paid in cash at the greater of its amortized cost value or market value and, with respect to any non-defaulted Eligible Security that is purchased, subject to a “claw-back” requirement that any profit realized from a subsequent sale of the security be remitted to the fund.⁵⁶ Prompt notice of any purchase under Rule 17a-9 by an affiliate, promoter, or principal underwriter, including identification of the security, its amortized cost, the sale price, and the reasons for the purchase, must be given to the SEC by e-mail.⁵⁷

Suspension of Redemptions

New Rule 22e-3 permits a money fund to suspend redemptions and payment of redemption proceeds, if: (a) the fund’s Board (including a majority of independent directors) determines that the deviation between the fund’s amortized cost price per share and the market-based NAV per share may result in material dilution or other unfair results; and (b) the Board irrevocably approves the liquidation of the fund. To rely on this Rule, however, the fund must notify the SEC by e-mail of its decision before redemptions are suspended.⁵⁸ In the

⁵⁶ See amended Rules 17a-9(a)(1)-(2) and (b)(1)-(2). In comparison, defaulted Eligible Securities are not required to comply with this new “claw-back” provision, since a default would serve as an objective indication that the security is distressed, and the purchase of such defaulted Eligible Securities would therefore be in the best interests of the fund. See Adopting Release, *supra* note 1, at text following n. 369.

⁵⁷ See amended Rule 2a-7(c)(7)(iii)(B).

⁵⁸ See Adopting Release, *supra* note 1, at section II.H. Temporary Rule 22e-3T under the Treasury’s guarantee

event that a liquidating fund fails to devise or properly execute a plan of liquidation that protects shareholders, the SEC retains the authority to rescind or modify the relief provided by the new Rule. A money fund that intends to rely on the new Rule may need to disclose in its prospectus the circumstances under which it may suspend redemptions.⁵⁹

Future Regulatory Steps

In her introductory remarks at the January 27th open meeting, SEC Chairman Mary L. Schapiro pledged that the SEC will continue to pursue more fundamental changes to the structure of money funds to protect them from the risk of broad-based, large-scale redemptions. Possible reforms under consideration include: replacing the stable \$1.00 share price with a floating NAV; requiring money funds to satisfy large redemption requests through in-kind redemptions; requiring money funds to disclose “shadow NAV” on a real-time basis; creating a private liquidity facility to provide liquidity to funds during times of stress; and creating a two-tiered system for money funds, with a stable NAV permitted only for money funds subject to greater risk-limiting conditions and liquidity facility requirements.⁶⁰ In light of these remarks, the recent amendments may simply be the first step in a major overhaul of the money market fund industry.



This update was authored by Jack W. Murphy (+1 202 261 3303; jack.murphy@dechert.com), Douglas P. Dick (+1 202 261 3305; douglas.dick@dechert.com), and Kevin K. Babikian (+1 949 442 6040; kevin.babikian@dechert.com).

program for money funds had provided a similar exemption for funds that participated in that program. The SEC adopted Rule 22e-3T a few days after Reserve broke the dollar and received an order from the SEC to suspend redemptions and postpone payments in the midst of a run on the fund. New Rule 22e-3 is intended to replace Rule 22e-3T, which expired in October 2009.

⁵⁹ See Adopting Release, *supra* note 1, at n. 378.

⁶⁰ See Mary L. Schapiro, Statement on Money Market Funds before the Open Commission Meeting (Jan. 27, 2010), available at <http://sec.gov/news/speech/2010/spch012710mls-mmfm.htm>.

Practice group contacts

For more information, please contact the authors, one of the attorneys listed, or any Dechert attorney with whom you regularly work. Visit us at www.dechert.com/financialservices.

Karen L. Anderberg

London
+44 20 7184 7313
karen.anderberg@dechert.com

Margaret A. Bancroft

New York
+1 212 698 3590
margaret.bancroft@dechert.com

Sander M. Bieber

Washington, D.C.
+1 202 261 3308
sander.bieber@dechert.com

Stephen H. Bier

New York
+1 212 698 3889
stephen.bier@dechert.com

Thomas C. Bogle

Washington, D.C.
+1 202 261 3360
thomas.bogle@dechert.com

Julien Bourgeois

Washington, D.C.
+1 202 261 3451
julien.bourgeois@dechert.com

Kevin F. Cahill

Orange County
+1 949 442 6051
kevin.cahill@dechert.com

Christopher D. Christian

Boston
+1 617 728 7173
christopher.christian@dechert.com

Elliott R. Curzon

Washington, D.C.
+1 202 261 3341
elliott.curzon@dechert.com

Douglas P. Dick

Washington, D.C.
+1 202 261 3305
douglas.dick@dechert.com

Ruth S. Epstein

Washington, D.C.
+1 202 261 3322
ruth.epstein@dechert.com

Joseph R. Fleming

Boston
+1 617 728 7161
joseph.fleming@dechert.com

Brendan C. Fox

Washington, D.C.
+1 202 261 3381
brendan.fox@dechert.com

Robert M. Friedman

New York
+1 212 649 8735
robert.friedman@dechert.com

David M. Geffen

Boston
+1 617 728 7112
david.geffen@dechert.com

David J. Harris

Washington, D.C.
+1 202 261 3385
david.harris@dechert.com

Christopher P. Harvey

Boston
+1 617 728 7167
christopher.harvey@dechert.com

Robert W. Helm

Washington, D.C.
+1 202 261 3356
robert.helm@dechert.com

Richard M. Hervey

New York
+1 212 698 3568
richard.hervey@dechert.com

Richard Horowitz

New York
+1 212 698 3525
richard.horowitz@dechert.com

Jane A. Kanter

Washington, D.C.
+1 202 261 3302
jane.kanter@dechert.com

Geoffrey R.T. Kenyon

Boston
+1 617 728 7126
geoffrey.kenyon@dechert.com

Matthew Kerfoot

New York
+1 212 641 5694
matthew.kerfoot@dechert.com

George J. Mazin

New York
+1 212 698 3570
george.mazin@dechert.com

Jack W. Murphy

Washington, D.C.
+1 202 261 3303
jack.murphy@dechert.com

Tram N. Nguyen

Washington, D.C.
+1 202 261 3367
tram.nguyen@dechert.com

John V. O'Hanlon

Boston
+1 617 728 7111
john.ohanlon@dechert.com

Reza Pishva

Washington, D.C.
+1 202 261 3459
reza.pishva@dechert.com

Edward L. Pittman

Washington, D.C.
+1 202 261 3387
edward.pittman@dechert.com

Jeffrey S. Poretz

Washington, D.C.
+1 202 261 3358
jeffrey.poretz@dechert.com

Jon S. Rand

New York
+1 212 698 3634
jon.rand@dechert.com

Robert A. Robertson

Orange County
+1 949 442 6037
robert.robertson@dechert.com

Keith T. Robinson

Hong Kong
+1 852 3518 4705
keith.robinson@dechert.com

Alan Rosenblat

Washington, D.C.
+1 202 261 3332
alan.rosenblat@dechert.com

Kevin P. Scanlan

New York
+1 212 649 8716
kevin.scanlan@dechert.com

Jeremy I. Senderowicz

New York
+1 212 641 5669
jeremy.senderowicz@dechert.com

Frederick H. Sherley

Charlotte
+1 704 339 3100
frederick.sherley@dechert.com

Stuart Strauss

New York
+1 212 698 3529
stuart.strauss@dechert.com

Patrick W. D. Turley

Washington, D.C.
+1 202 261 3364
patrick.turley@dechert.com

Brian S. Vargo

Philadelphia
+1 215 994 2880
brian.vargo@dechert.com

Jennifer O. Wood

London
+44 20 7184 7403
jennifer.wood@dechert.com

Anthony H. Zacharski

Hartford
+1 860 524 3937
anthony.zacharski@dechert.com