The Investment Lawyer
Covering Legal and Regulatory Issues of Asset Management
VOL. 22, NO. 3 • MARCH 2015

Mutual Funds and Loan Investments

By Stephen H. Bier, Julien Bourgeois, and Joseph McClain

The loan market has grown dramatically during the past 20 years in the United States.[1] Recent growth of this market has coincided with the increasing popularity of mutual funds that invest in loans as a retail investment option. While still a relatively modest portion of the overall lending market, assets in these funds grew by an estimated 82.5 percent in 2013.[2] Because these funds tend to have higher yields than government and investment grade bond funds and the loans are often floating rates (that is, interest rates charged for loans can increase in response to increases in market interest rates), they have become an increasingly popular investment option in the current low yield environment, particularly with the expectation that the Federal Reserve Board will be raising interest rates.

While loans have become more popular in mutual funds, both as stand-alone loan funds as well as funds that include loans among their permitted investments, these funds present certain operational and regulatory challenges in their management and oversight. Following an overview of the loan market, this article will review the legal and regulatory issues relating to the operation of mutual funds that invest in loans with respect to liquidity, valuation, custody, direct lending and risk management.

I. Overview of the Loan Market

The primary demand market for loans (that is, syndicated bank loans and similar loans) consists of commercial borrowers and lenders privately negotiating for extensions of credit to finance a variety of corporate activities, including mergers or acquisitions, recapitalization of the borrower's balance sheet, debt refinancing and, to a lesser extent, general corporate purposes.[3] The growth of the loan market has been dependent upon, among other factors, the maturity of the secondary market, including the market's liquidity, and the efficiency and cost of administering loans.[4] In a typical loan, an administrative agent, usually a commercial bank that originates the loan and organizes the syndicate, will primarily be responsible for negotiating the loan documents. Additionally, the administrative agent will generally be responsible for administering and enforcing the terms of the loan documents, including any restrictive covenants, and collecting payments of principal, interest and any fees to which the syndicate is entitled. Ownership interests in the loan are usually maintained by the administrative agent. The loan documents themselves are not a negotiable instrument (that is, possession of them cannot be used to obtained the principal, interest and fee payments from the borrower).

The pricing of a loan in the primary demand market entails a detailed credit analysis of the corporate borrower and is often negotiated early. Typically, a loan is priced with a floating interest rate component, paying rates that are periodically determined by reference to a base lending rate (for example, the London Interbank Offered Rate (LIBOR)) plus a premium. Major ratings agencies also rate certain

Copyright © 2015 by CCH Incorporated. All Rights Reserved.

syndicated loans, employing similar methodologies used when rating other fixed income instruments.

In the secondary market, investors may invest in loans through participations and assignments. In a participation, an investor typically enters into a contractual relationship with the lender and not with the corporate borrower. As a result, an investor generally receives the right to payments of principal, interest, and fees to which it is entitled only from the lender selling the participation, and only upon receipt by the lender of payments from the corporate borrower. When an investor purchases an assignment, all legal, beneficial, and economic rights of the assigned loan transfer to the assignee. Since legal title passes from the selling lender to the investor, the investor also assumes the obligations of the selling lender.

II. Liquidity

The loan trading industry (and notably the Loan Syndications and Trading Association[5] (LSTA)) has been working for many years on standardizing loan trading documents. The industry does so with a view to facilitate secondary market transactions, streamline loan assignments and improve the settlement process. In many respects, the industry has had great success. However, many loans and assignment trades remain bespoke transactions that require consents from borrowers or key syndicate members, and loan documents are still negotiated written documents that require human review. As a result, while data supports the proposition that the loan market is more liquid than some other fixed income markets, the mechanics of loan trades and certain trade settlement times cause funds to carefully monitor liquidity considerations surrounding loan investments.

The obligation of open-end registered investment companies to maintain a high level of liquidity arises from Section 22(e) of the Investment Company Act of 1940, as amended (the 1940 Act), which requires an open-end investment company to pay redemption proceeds within seven days upon the tender of shares for redemption. The SEC Staff takes the position that an open-end fund (other than a money market fund) may have no more than 15 percent of its net assets invested in illiquid assets.[6] Even though the SEC has stated that a fund's board of directors is ultimately responsible for determining whether a security is liquid, the board may, subject to sufficient oversight, delegate its day-to-day responsibility of determining liquidity to the fund's investment adviser or sub-adviser.[7]

A long time ago, the SEC raised questions as to the liquidity of certain participations and interests in certain syndicated loans.[8] However, this was a time when, on the regulated fund side, only a few prime rate closed-end funds invested in those instruments. Since then, the liquidity of the loan market has been bolstered by a very large increase in the number of market participants, the advent of standardized documents related to the purchase, sale and closing of loan trades, and independent pricing services. As a result, it is widely accepted that a loan investment may be considered liquid if it can be freely traded in the secondary market and facts and circumstances support a finding of liquidity in that market. In making this determination, the fund must reasonably believe that it will be able to strike a contract price for the sale or assignment of a syndicated loan within seven days at approximately the value at which the fund values the syndicated loan.[9]

Funds, their directors and investment advisers nevertheless establish liquidity determination and monitoring processes to determine the liquidity of loan portfolios and they monitor evolutions in the loan market closely. They typically consider factors common to general liquidity determinations, as well as factors specific to the loan markets, which can include: (i) the legal limitations on the transferability or sale of a loan including the requirement to obtain consents from borrowers or syndicate agents and members prior to assignment; (ii) the existence of a trading market for the loans and the estimated depth of the market; (iii) the frequency of trades or quotes for the loan; (iv) the estimated length of the settlement period; and (v) the borrower's health.

Copyright © 2015 by CCH Incorporated. All Rights Reserved.

Beyond liquidity determinations of individual loans, it is our experience that loan funds and their investment advisers often have specific processes to monitor overall liquidity risk of the fund portfolios, and test to estimate liquidity positions depending on possible changes in the economic environment or shareholder activity levels. Loan funds also typically have lines of credit that are available in case they need access to liquidity to satisfy shareholder redemption requests and do not want to sell a portfolio's most liquid positions or pending settlement.

III. Valuation

Rule 22c-1 under the 1940 Act requires open-end investment companies to process each purchase and redemption order at a price based on the fund's net asset value (NAV) next computed after the fund receives the order and to value their portfolio securities at least once a day on each business day. Section 2(a)(41) of the 1940 Act and Rule 2a-4 thereunder generally requires that a fund value a portfolio security at its current market value if market quotations are readily available. However, when market quotations are not readily available, a fund's board of directors is required under Section 2(a)(41) and Rule 2a-4 to make a good faith determination as to the fair value of the securities.[10] The SEC has expressed the view that fair valuation depends upon the facts and circumstances of the individual security, prevailing market conditions and all other appropriate factors in which the security is traded.[11] The SEC has interpreted "fair value" to mean the amount that a fund might "reasonably expect to receive for [a] security upon [its] current sale."[12]

The SEC has identified fair valuation procedures as a critical element of a fund's compliance program. The SEC has stated that a fund must adopt policies and procedures that (i) monitor circumstances that may necessitate fair valuation; (ii) establish criteria for determining when market quotations may no longer be reliable; (iii) provide methodologies to determine the fair value of a security; and (iv) regularly review the accuracy and appropriateness of the methods employed to determine a security's fair value.[13]

When applying the 1940 Act definition of "value"[14] to loans, it is helpful to consider the way that funds typically treat other fixed income instruments, particularly bonds. As with bonds, loans do not trade on an exchange; however, certain loans do trade frequently and are traded by multiple market makers who may quote bid and ask prices. Other loans trade much less frequently and are traded by few, if any, established market makers. Also, as with other fixed income securities, the market practice by most mutual funds is to rely on third-party pricing services rather than to seek quotes from market makers. With respect to loans, there are a number of independent pricing services that provide prices on certain loans on a daily basis.

These pricing services typically utilize a variety of methodologies to price loans. For loans that trade frequently with multiple sources, the pricing services will often supply a market price that reflects an average of quoted prices. In other cases, particularly where a loan does not trade frequently, the pricing service may utilize an "evaluated price" based on a model that has a variety of inputs (for example, discounted cash flow analysis, valuation data for similar instruments and other market and issuer data). This is sometimes referred to as matrix pricing. In other situations, the pricing service incorporates a blend of market information relating to the specific loan and matrix pricing.

While funds benefit from using pricing services due to their specialized expertise, extensive market data, and the lack of direct conflicts in their pricing decisions, it is incumbent on fund management and boards to take steps to appropriately utilize these pricing services. These steps should include some type of due diligence process to ascertain information about the quality and reliability of the pricing service. In addition, appropriate personnel should understand the services provided by the pricing service, or what the SEC characterizes as considering the "inputs, methods, models and assumptions"

Copyright © 2015 by CCH Incorporated. All Rights Reserved.

used by the pricing services for the particular instruments being priced, as well as an understanding of the timing of the valuation information provided and how market conditions may impact these prices and this information also should be communicated with the fund's board.[15] While we have observed different approaches, fund management generally provides periodic reports to the board and representatives of the pricing services may present to the board periodically.

To the extent that funds engage in direct lending, which is discussed in more detail below, the fund may need to develop its own fair valuation methodology to value the loan, which will also be subject to the board's approval. In addition, to the extent that direct lending constitutes more than a *de minimis* portion of the fund's portfolio, consideration should be given to utilizing a third-party service to independently review these valuations to address the inherent conflicts of an internal valuation model. Direct lending is commonly done by business development companies (BDC) that specialize in this type of investment.

While the choice of service providers and valuation methodologies used to price loans are important ones, it is equally important that the fund's valuation policies and procedures have strong processes in place. These processes include the due diligence and oversight of the third-party pricing service and reports to the board, as well as appropriate pricing committee membership and a challenge process that incorporates internal expertise, but contains appropriate checks and balances to address conflicts. As we learned during the 2007-2008 financial crisis, weaknesses in fund valuation policies and procedures are more likely to become apparent in stressed markets, which may lead to potential liability for investment advisers and fund boards.

IV. Custody

Section 17(f) of 1940 Act requires that a fund's "securities and similar investments" be placed and maintained in the custody of a bank, member firm of a national securities exchange or the fund itself, subject to certain conditions or in accordance with the rules and regulations or orders as the SEC may prescribe. Section 17(f) is intended to protect the safety of the investors' assets and prevent self-dealing by controlling persons of funds.[16] However, the application of Section 17(f) to loans is not clear cut. In 1992, the SEC issued a no-action letter to a Merrill Lynch fund that invested in loans and stated that it would not bring an enforcement action against the fund for violating Section 17(f) if (i) the fund's custodian would hold relevant documentation evidencing the fund's ownership in the loan; (ii) the documentation would permit the custodian to enforce all the fund's ownership rights in a court of law; and (iii) the administrative agents, in transmitting interest and principal payments to the fund, do not hold assets of the fund, but act as paying agents.[17] This discussion in the letter, however, was based in part on the rights that were deemed to attach to the holder of the loan documents.

While a number of funds follow the practice outlined in this no-action letter, we have seen varying practices with respect to loan custody. As noted above, the ownership interest in a loan is often maintained by the administrative agent and the loan documents themselves do not actually reflect an ownership interest in the loans. Moreover, in our experience, fund custodians will often refuse to maintain possession of the fund's loan documents and, even when they do agree to hold these documents, will do so without conceding that this activity is deemed to constitute custody. Further, when auditors verify that funds hold custody of their assets, they typically do so by confirming the fund's ownership with the administrative agent rather than reviewing whether the fund's custodian is holding the loan documents.

While the custody requirements of the Investment Advisers Act of 1940, as amended (the Advisers Act), are not directly applicable to fund custody, which is governed by Section 17(f) and the rules adopted thereunder, recent amendments to Rule 206(4)-2 under the Advisers Act provide an exception to the custody requirements for privately

Copyright © 2015 by CCH Incorporated. All Rights Reserved.

offered securities that are un-certificated and ownership thereof is recorded only on the books of the issuer or its transfer agent in the name of the client and is transferable only with the prior consent of the issuer or holders of the outstanding securities of the issuer. In the release adopting this exception, the SEC indicated that the "[t]hese impediments to transferability provide some external safeguards against the kinds of abuse the rule seeks to prevent." While Rule 206(4)-2 under the Advisers Act does not impact the requirements of Section 17(f) of the 1940 Act directly, the recent amendments to this rule indicate that the SEC understands that privately issued un-certificated instruments present different risks than the types of "securities and similar instruments" that Congress was concerned about when enacting Section 17(f).

V. Direct Lending

We have seen loan portfolio investments by open-end investment companies evolve over the years. Initially, funds invested primarily in loan participations issued by banks and loan assignments purchased from initial loan syndicate members or secondary market participants, including other funds. In the past ten years or so, many funds have also started to invest in loans through direct lending, thus joining traditional syndicate lenders, in order to have better access to loan and related fixed income investment opportunities, more influence over loan terms or obtain better yields. They hold loans to maturity or may eventually sell them on the secondary market. The types of loan investments they make have also evolved, from traditional syndicated floating rate loans to loan commitments, bridge loans, and similar transactions. There are a number of topics that funds engaging in these transactions need to consider under the 1940 Act and under other federal and state laws, some of which are outside of the scope of this article. The following is a short, non-exclusive summary of the issues we routinely consider.

First, while there is no provision under the 1940 Act that prohibits direct lending, funds will need to ensure that their recital of fundamental investment policies required pursuant to Section 8 of the 1940 Act permits them to lend money to others. Otherwise they will need to seek shareholder approval to amend their policy. They also will need to carefully consider related investment and risk disclosures tied to direct loans, particularly with respect to liquidity, valuation, trading and settlement considerations. Depending on the type of lending transactions, funds will need to consider whether "senior security" considerations could be deemed to arise under Section 18(f), particularly with respect to periods leading to closing lending transactions (in which case a fund may be committed to deliver a precise amount upon closing). At that point, the fund should consider the amount of assets available to cover its commitments and related considerations, such as liquidity considerations with regard to corresponding fund assets.

Section 17 of the 1940 Act will need to be carefully considered. In our experience, it is necessary for funds to put in place solid processes to identify affiliates in order to avoid potential issues under Section 17(a), which prohibits the purchase and sale of securities among funds and first- or second-tier affiliates, and the lending of money or other property by a fund to these affiliates. Absent solid processes, a fund runs the risk of being in violation of Section 17(a) when it lends to a company that is a first- or second-tier affiliate. Some of the rules under the 1940 Act (for example, Rule 17a-6) can provide relief, but only under limited circumstances, and they can be burdensome to follow. Section 17(d) and Rule 17d-1 together prohibit first- and second-tier affiliates from entering into "joint enterprise or other joint arrangement or profit sharing plans" with a fund. These provisions will cause a fund to carefully consider whether participating in a direct lending opportunity is possible where an affiliate could be deemed to have an interest in the transaction, either because it is a co-lender, it has a role in the lending syndicate, or because it is advising or has equity investments in the borrower. Even side-by-side loans by similarly situated funds in

Copyright © 2015 by CCH Incorporated. All Rights Reserved.

the same fund complex will need to be reviewed in light of these provisions and applicable SEC Staff views. The scope of the 2000 no-action letter issued to Massachusetts Life Insurance Company,[18] which relates to aggregated purchase and sale orders will need to be reviewed and applied carefully.

In our experience, Section 17 will cause funds to consider each lending opportunity independently, carefully consider facts and circumstances, and be ready to pass on investment opportunities when a complete analysis cannot be conducted. This review will imply close and candid cooperation among investment, legal, compliance, tax and accounting teams. Those who also manage BDCs and closed-end funds that have received exemptive relief from certain prohibitions included in Section 17 will need to remember that open-end funds typically have not received the same relief and will not be able to participate in certain transactions in which the other regulated investment vehicles will be permitted to engage. As discussed above, direct lending opportunities will cause funds to consider whether the custody arrangements that they have in place in order to comply with Section 17(f) of the 1940 Act are adapted to direct lending arrangements, which could require the fund custodian to maintain original lending documents.

Funds that participate in direct lending opportunities have done so for long-term investment purposes. Funds will want to avoid doing so with a view to re-selling the loans, otherwise certain questions could arise under other federal securities laws as funds would not want to be deemed to be engaging in underwriting activities. Finally, funds will want to be attentive to state and local regulations to avoid situations where lending could potentially be subject to specific state notification or licensing obligations. In our experience, however, these are rare instances.

VI. Risk Management and Evolving Market Environment

In January 2014, the SEC's Division of Investment Management (IM Division) published guidance (Guidance)[19] addressing steps that funds and fund investment advisers should consider in light of changes in the markets for fixed income securities. The Guidance explains that recent fixed income market volatility and fund outflows are occurring in the context of a different environment as compared to previous periods of rising interest rates. Specifically, the Guidance observes that market-making capacity in the fixed income markets has declined as a result of reduced broker-dealer inventories relative to fund assets, reduced broker-dealer proprietary trading activity and increased regulatory capital requirements applicable to broker-dealer holding companies. As the Guidance explains, "[a] significant reduction in dealer market-making capacity has the potential to decrease liquidity and increase volatility in the fixed income markets."[20] The IM Division suggests that funds and their investment advisers consider taking affirmative steps to manage these potential risks and assess the adequacy of their existing risk disclosure in shareholder reports.

Investment advisers that manage fixed income portfolios could be subject to varying degrees of investment risk in these changing investment and interest rate environments. Investment advisers are recommended in the Guidance to employ a combination of thorough and continuous credit analysis, including an analysis of an issuer's ability to make loan or debt payments in different interest rates. On a fund level, the Guidance indicates that investment advisers may wish to conduct assessments of a fund's overall liquidity and a fund's ability to meet potential redemptions during both normal and stressed environments, and such assessments may include needs and sources of fund liquidity over various periods of time. Beyond liquidity stress tests, the Guidance suggests that investments advisers may want to consider assessing the impact of certain factors more generally, including, among others, increases in interest rates and volatility, widening spreads, and price shocks to fixed income products. The Guidance also recommends that investment advisers employ multi-variable stress

Copyright © 2015 by CCH Incorporated. All Rights Reserved.

tests under different circumstances to analyze a fund's portfolio, and use the results to make investment decisions with respect to portfolio composition, concentration, diversification and liquidity.

In our experience, loan fund managers have long considered risks around loan investments and put in place risk management programs specific to that asset class that covered most areas, if not all, of those covered in the Guidance.[21] And while the Guidance is not focused on the loan asset class, we have seen many loan managers review and update their risk management program and fund documents. We have observed enhanced internal risk monitoring processes and enhanced reporting of perceived risks to fund boards, including stress-test-like reports. These risk management tools are sometimes inspired by the stress tests processes and reports that were put in place a few years ago for money market funds as a result of Rule 2a-7 and related amendments.

We have also observed an evolution of disclosures for funds that invest in loans, to focus on investment risks more acutely applicable to that asset class, notably in order to more clearly reflect liquidity, valuation and settlement risks tied to loan investments and consequences on the fund and its investors. The SEC Staff in charge of reviewing fund registration statement disclosures also plays an important role, as we have noted, as they focus on loan investments. The Staff has become familiar with the asset class, and are expecting direct, plain-English, disclosures that adequately reflect risks. They also expect funds to disclose clearly their loan investment strategies and the types of loans in which they intend to invest.

Nevertheless, investment advisers should remember to be proactive in their communications with fund boards to keep them fully informed about loan investments. Because the IM Division recommends that investment advisers provide boards with liquidity and risk exposure reports, advisers who do not already do so should have an open dialogue with directors with respect to portfolio investments and their foreseen ability to manage loan funds during periods of increased volatility and rises in interest rates. In addition, funds should continuously assess whether their existing disclosure in registration statements and shareholder reports adequately cover evolutions in loan investments and related risks. Funds may determine that it is necessary to periodically make changes to investment strategies discussions, for example to disclose new types of loans in which they may invest. They may also become aware of specific risks, notably through their risk management processes, that are not currently adequately disclosed, or that are the result of changes in the markets. To the extent a fund determines its risk disclosure could be enhanced, it would be advisable to do so. It is also advisable to periodically consider the adequacy of a fund's line(s) of credit or its non-loan investments with respect to their ability to provide a liquidity cushion in stressed markets.

It is worthy of note that recently, the SEC and other regulators have re-affirmed their concern that funds may not always be properly identifying and communicating the risks associated with changes in the fixed income markets. For example, the SEC's Office of Compliance Inspections and Examinations (OCIE) published its 2015 examination priorities that highlighted certain practices and investments that could pose a heightened risk to investors.[22] In the context of retirement savings, OCIE stated that it intends to "review whether mutual funds with significant exposure to interest rate increases have implemented compliance policies and procedures and investment and trading controls sufficient to ensure that their funds' disclosures are not misleading and that their investments and liquidity profiles are consistent with those disclosures." In a similar vein, the Financial Industry Regulatory Authority (FINRA) recently published its Regulatory and Examinations Priority Letter[23] and noted that it intends to review the suitability and adequacy of disclosure for fixed income funds in 2015. FINRA also stated that it may review each member's efforts to educate registered representatives and potential investors about such products. These are reminders to loan funds and their advisers that they need to

Copyright © 2015 by CCH Incorporated. All Rights Reserved.

remain focused on that specific asset class and how they explain it to investors.

VII. Conclusion

Investments in loans have become an increasingly important component of the fixed income mutual fund product set. Funds that participate in this market should be attentive to the relevant regulatory issues, provide meaningful disclosure to investors, manage risks in a sophisticated fashion and regularly communicate about these matters with fund boards.

Stephen H. Bier and **Julien Bourgeois** are partners, and **Joseph McClain** is an associate in the Financial Services Group of Dechert LLP. Their email addresses are *stephen.bier@dechert.com, julien.bourgeois@dechert.com* and *joseph.mcclain@dechert.com*.

NOTES

1 *See A Guide to the U.S. Loan Market* (September 2013), Standard & Poor's Financial Services LLC, hereinafter referred to as "A Guide to the U.S. Loan Market." For example, the 3Q 2014 LSTA Secondary & Settlement Study by The Loan Syndications and Trade Association reports that the par amount outstanding in the S&P/LSTA Leveraged Loan Index has increased by approximately 60 percent or $300 billion in the past four years.

2 Lipper FMI and S&P Capital IQ LCD as of 12/31/2013.

3 *See A Guide to the U.S. Loan Market*, 5, n.1, *supra*.

4 *Id.*

5 In 1995, the LSTA was founded as "a not-for-profit organization dedicated to promote the orderly development of a fair, efficient, liquid and professional trading market for the loan asset class." Prior to the organization of the LSTA, the settlement period was lengthier, owing largely to the complexity and negotiated character of the closing documents. With standardized closing documents, however, settlement periods have reduced drastically.

6 *See Revisions of Guidelines to Form N-1A*, Inv. Co. Act Rel. No. 18612 (Mar. 12, 1992), *see also Guide 4 to Form N-1A*, Inv. Co. Act Rel. No. 13436 (Aug. 12, 1983). Although the guides have been rescinded (*see* Inv. Co. Act Rel. No. 23064 (Mar. 13, 1998) at note 214), the SEC Staff still frequently refers to them.

7 *See* Inv. Co. Act Rel. No 17452 (April 23, 1990). Discussing mutual fund investments in restricted securities, the SEC stated, "The Commission believes that the ultimate responsibility for liquidity determinations is that of the board of directors. However, the board may delegate the day-to-day function of determining the liquidity of securities to the fund's investment adviser, provided that the board retains sufficient oversight."

8 *See* Inv. Co. Act Rel. No. 18869 (July 28, 1992) (loans and loan participation interests might not satisfy liquidity standards of Section 22(e) of the Investment Company Act); *Id.,* n. 58 (citing certain closed-end mutual funds that invested in illiquid assets, including interests in senior, secured corporate loans that have floating interest rates).

9 *See* Inv. Co. Act Rel. No. 18612 (March 12, 1992). The Investment Company Institute (ICI) has expressed the view that, rather than requiring the settlement (*i.e.*, the receipt of proceeds) of a sales transaction within seven days, the SEC's liquidity standard requires only that a contract price be struck with respect to such sale. *See* Investment Company Institute, Valuation and Liquidity Issues for Mutual Funds (1997). It is worthy of note that neither the SEC nor its Staff has issued any contrary guidance since that time.

10 Generally, a market price may not be readily available if, for example, the security is not regularly traded in the market, the exchange/market on which the security is traded does not open for trading for an entire day and no other market prices are available, or a "significant event" occurs after the exchange/market on which the security is traded has closed.

11 Accounting Series Release No. 118 (Dec. 30, 1970) (ASR No. 118).

12 *Id.* The Financial Accounting Standards Board has provided similar guidance. According to FASB, fair

Copyright © 2015 by CCH Incorporated. All Rights Reserved.

value is "the price that would be received [for the security] … in an orderly transaction between market participants at the measurement date." FASB Topic 820, Fair Value Measurements (Jan. 2010).

13 *Compliance Programs of Investment Companies and Investment Advisers*, Rel. No. IA-2204 (Dec. 17, 2003).

14 As noted, Section 2(a)(41) of the Act defines "value" as market value, "where market quotations are readily available" or fair value as determined in good faith by the fund's board of directors.

15 *See e.g.*, *Money Market Fund Reform; Amendment to Form PF*, Release No. IC-31166 (July 23, 2014) (Adopting Release for amendments to Rule 2a-7).

16 *See e.g.*, Final Rule: Custody of Investment Company Assets with a Securities Depositary, March 28, 2003, available at *http://www.sec.gov/rules/final/ic-25934.htm*. The SEC notes that Section 17(f) was "designed to assure the safety of the fund's assets."

17 Merrill Lynch Prime Fund, SEC No Action Letter (pub. Avail. Nov 4, 1992).

18 Publicly Available June 7, 2000.

19 Risk Management in Changing Fixed Income Market Conditions, IM Guidance Update No. 2014-01, available at *http://www.sec.gov/divisions/investment/guidance/im-guidance-2014-1.pdf*.

20 *Id.*

21 One may observe that the asset class overcame the liquidity challenges of the 2008 financial crisis and that it now has deeper liquidity.

22 "Examination Priorities for 2015," Office of Compliance Inspections and Examinations, available at *http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf*.

23 Regulatory and Examinations Priorities Letter, published on January 6, 2015, available at *http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p602239.pdf*.

Copyright © 2015 CCH Incorporated. All Rights Reserved
Reprinted from *The Investment Lawyer*, March 2015, Volume 22, Number 3, pages 1, 4–11,
with permission from Wolters Kluwer, New York, NY,
1-800-638-8437, www.wklawbusiness.com

Copyright © 2015 by CCH Incorporated. All Rights Reserved.