

MEMO# 29357

September 18, 2015

SEC Removes Credit Rating References from Rule 2a-7

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TO: INVESTMENT COMPANY DIRECTORS No. 29-15
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 31-15
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 21-15 RE: SEC REMOVES CREDIT RATING REFERENCES FROM RULE 2a-7

Earlier this week, the Securities and Exchange Commission amended Rule 2a-7 to remove the rule's references to credit ratings and eliminate an exclusion from the rule's issuer diversification provisions that is currently available for securities subject to a guarantee by a non-controlled person. [\[1\]](#) The SEC acted unanimously and without holding an open meeting.

Removal of Credit Ratings

Under amended Rule 2a-7, a money market fund must limit its portfolio securities to "eligible securities," which are securities that the fund's board or its delegate determines to present minimal credit risks to the fund. Eligible securities will no longer be divided into first-tier and second-tier securities. The eligibility determination must include an analysis of the capacity of the security's issuer or guarantor to meet its financial obligations. This analysis must include, to the extent appropriate, the following codified factors:

- consideration of the issuer's or guarantor's financial condition,
- its sources of liquidity,
- its ability to react to future events, and
- the competitive position of the firm and its industry.

The Release explains that the codified credit factors should establish a minimum baseline that should help guard against the risk that funds' approach to credit analysis will become less uniform, or that some funds would substantially increase the riskiness of their portfolios. Although asset-specific factors were not codified in the rule, the release notes a number of factors that fund advisers may wish to consider regarding municipal securities, conduit securities, asset-backed securities, other structured securities (such as VRDNs, TOBs, etc.), and repurchase agreements. [\[2\]](#) Eligible securities also include government securities and money market fund shares.

Further, money market funds will be required to adopt written procedures requiring the fund adviser to provide ongoing review of whether each security (other than government securities) continues to present minimal credit risks. Although the rule does not include a specific monitoring frequency, the release notes that ongoing monitoring efforts should occur on a regular and frequent basis. The SEC notes that the removal of credit ratings is not intended to change the current risk profile of money market funds. In addition, although credit ratings have been removed from the rule, money market funds will be required to disclose on Form N-MFP each credit rating that was considered in determining that the securities presents minimal credit risks.

Issuer Diversification

The amendments also revise Rule 2a-7 to remove the current exclusion from the issuer diversification requirement for securities that are subject to a guarantee. As a result, taxable money market funds must not invest more than 5 percent of their total assets in securities issued by a single issuer, including securities with a guarantee. As currently required, no more than 10 percent of their total assets may be guaranteed by a single guarantor.

Tax-exempt money market funds must not invest more than 5 percent of their total assets in securities issued by a single issuer, including securities with a guarantee. As currently required, the issuer limitation applies to only 75 percent of the assets of single state funds. The 10 percent guarantee limitation applies to only 75 percent of the assets of single state funds and only 85 percent of the assets of other tax-exempt funds.

Funds must comply with the rule amendments by October 14, 2016.

Jane G. Heinrichs
Associate General Counsel

endnotes

[1] Removal of Certain References to Credit Ratings and Amendments to the Issuer Diversification Requirement in the Money Market Fund Rule, SEC Release No. IC-31838 (September 16, 2015), available at <http://www.sec.gov/rules/final/2015/ic-31828.pdf>.

[2] Release at 22-24.