

**MEMO# 28290**

July 31, 2014

## **SEC Adopts New Money Market Fund Rules**

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 19-14  
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 34-14  
BROKER/DEALER ADVISORY COMMITTEE No. 39-14  
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 17-14  
MONEY MARKET WORKING GROUP  
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 14-14  
OPERATIONS MEMBERS No. 11-14  
SEC RULES MEMBERS No. 33-14  
SMALL FUNDS MEMBERS No. 19-14  
TAX MEMBERS No. 22-14  
TRANSFER AGENT ADVISORY COMMITTEE No. 49-14 RE: SEC ADOPTS NEW MONEY MARKET FUND RULES

Last week, in a 3-2 vote, the SEC adopted amendments to the rules that govern money market funds. [\[1\]](#) According to the SEC, the rules are designed to address money market funds' susceptibility to heavy redemptions in times of stress, improve their ability to manage and mitigate potential contagion from such redemptions, and increase the transparency of their risks, while preserving, as much as possible, their benefits. A brief summary of the 869-page adopting Release is provided below.

At the same time, the SEC also issued a related notice proposing exemptions from certain confirmation requirements for transactions effected in shares of floating NAV money market funds. [\[2\]](#) Additionally, the SEC repropoed amendments to the SEC's money market fund rules and Form N-MFP to address provisions that reference credit ratings. [\[3\]](#) A memorandum describing these two proposals is forthcoming.

## **Floating NAV for Institutional Prime and Institutional Tax Exempt Money Market Funds**

The amendments require institutional prime and institutional tax exempt money market funds to value their portfolio securities at market value and sell and redeem shares based

on a floating NAV. These funds may no longer use amortized cost to value their portfolio securities, except for securities that mature within 60 days. The Release explains that the new floating NAV requirement is not intended nor does it seek to deter redemptions that constitute “rational risk management by shareholders or that reflect a general incentive to avoid loss,” but rather is designed to achieve two independent objectives: (i) to reduce the first mover advantage inherent in a stable NAV fund by dis-incentivizing redemption activity that can result from investors attempting to exploit the possibility of redeeming shares at a stable share price even if the portfolio has suffered a loss; and (ii) to reduce the chance of unfair investor dilution, which would be inconsistent with a core principle of the Investment Company Act of 1940. The Release also suggests that an additional motivation for this reform is because the floating NAV may make it more transparent to certain of the impacted investors that they, not the fund sponsors or the federal government, bear the risk of loss.

### **“Basis Point” Rounding**

The final rules require institutional prime and institutional tax exempt funds to round prices and transact in fund shares to four decimal places in the case of a fund with a \$1.00 target share price (i.e., \$1.0000) or an equivalent or more precise level of accuracy for money market funds with a different share price (i.e., \$10.000 or \$100.00). This level of precision is 100 times more sensitive than currently in effect for a money market fund and 10 times more sensitive than for a non-money market fund. Accordingly, the amendments change the rounding convention for money market funds that are required to adopt a floating NAV—from penny rounding (i.e., to the nearest one percent) to “basis point” rounding (i.e., to the nearest 1/100th of one percent). The Release explains that basis point rounding reduces the benefit from redeeming ahead of others to at most one half of a hundredth of a cent per share (e.g., a floating NAV fund at four decimals will adjust from \$1.0000 to \$0.9999 as soon as the value reaches \$0.99995). In considering whether to require basis point rounding (e.g., \$1.0000) or to allow 10 basis point rounding (e.g., \$1.000), the SEC considered the potential for price fluctuations under the two approaches. Based on SEC staff analysis of Form N-MFP data over a three year period, the staff found that 53 percent of money market funds have fluctuated in price over a twelve-month period with a NAV priced using basis point rounding, compared with less than 5 percent of money market funds that would have fluctuated in price using 10 basis point rounding. The Release concludes that pricing with an accuracy of basis point rounding should better reflect the nature of money market funds as an investment product by regularly showing market gains and losses in a fund’s portfolio.

## **Stable NAV Permitted for Government and Retail Money Market Funds**

Government money market funds and retail money market funds may continue to seek to maintain a stable NAV using amortized cost valuation and/or penny rounding. Under the proposal, stable NAV money market funds would have been prohibited from using amortized cost to value portfolio securities; however, the SEC agreed with commenters, including ICI, that eliminating amortized cost valuation would likely hinder the ability of funds to provide frequent intraday liquidity to shareholders and may impose unnecessary costs and operational burdens on stable NAV money market funds.

### **Government Money Market Fund**

Under the amendments, government money market funds are defined as a money market

fund that invests at least 99.5 percent of its total assets in cash, government securities, and/or repurchase agreements that are collateralized by cash or government securities. Although the proposal would have permitted government funds to invest up to 20 percent of fund assets in non-government securities, the SEC determined that a basket that large may promote a type of hybrid money market fund that presents new risks that are not consistent with the purposes of the new money market fund reforms.

## **Retail Money Market Fund**

The new rules define a retail money market fund as a money market fund that has policies and procedures reasonably designed to limit all beneficial owners of the fund to natural persons. The Release notes that “beneficial ownership” typically means having voting and/or investment power.

This definition reflects several modifications from the SEC’s proposal (in which a retail fund was defined as a fund that limits redemptions to \$1 million in a single business day). Commenters, including ICI, expressed concern that the proposed definition of a retail money market fund would have been operationally difficult and burdensome. The SEC agreed and determined that using the natural person test to define a retail fund provides a simpler and more cost-effective way to accomplish its goal of targeting the floating NAV reform to the type of money market fund that has exhibited greater tendencies to redeem first in times of market stress. The Release explains that defining a retail fund using the natural person test will, as a practical matter, significantly reduce opportunities for “gaming behavior” by certain investors (whereby an investor having the general attributes of an institution might attempt to fit within the confines of whatever retail definition the SEC crafts) because most funds will use social security numbers (which are not issued to institutional investors) as part of their compliance process to limit beneficial ownership to natural persons. The Release also notes that a money market fund or an intermediary could determine the beneficial ownership of a non-U.S. natural person by obtaining other government-issued identification, such as a passport.

The SEC expects a fund that intends to qualify as a retail money market fund to disclose in its prospectus that it limits investments to accounts beneficially owned by natural persons. It also notes that funds will have flexibility in how they choose to comply with the natural person test, including how the fund will reasonably conclude that underlying beneficial owners of an omnibus account are natural persons. The Release notes that there are many ways for a fund to effectively manage its relationships with its intermediaries, including contractual arrangements or periodic certifications. Regardless of the specific policies and procedures followed by a fund in reasonably concluding that the underlying beneficial owners of an omnibus account are natural persons, the SEC expects a fund will periodically review the adequacy of such policies and procedures and the effectiveness of their implementation. [\[4\]](#)

## **Exemptive Relief Granted to Restructure Funds as Retail Funds**

The SEC recognizes that to qualify as a retail money market fund, funds with separate share classes for different types of investors (as well as single-class funds for both types of investors) will need to reorganize into separate money market funds for retail and institutional investors. To help facilitate this reorganization, the Release sets forth exemptive relief from Sections 18 and 17(a) of the Investment Company Act that might otherwise forbid a fund to separate retail and institutional shareholders, provided the fund’s board of directors, including a majority of the independent directors, determines that the reorganization results in a fair and approximately pro rata allocation of the fund’s assets

between the class being reorganized and the class remaining in the fund. To facilitate situations in which a money market fund may need to involuntarily redeem certain investors that will no longer be eligible to invest in the newly established or existing money market fund, the Release also provides exemptive relief from Section 22(e) of the Act, provided shareholders are notified at least 60 days in advance.

### **Tax Implications of Floating NAV Money Market Funds**

The Treasury and IRS have issued proposed regulations that would permit investors in floating NAV money market funds to elect to use a simplified aggregate accounting method. Pursuant to this “NAV method,” investors would determine gain or loss by looking at the change in the aggregate value of the investor’s shares in the money market fund over a specified period rather than tracking individual lots or adjusted cost basis of the fund shares. The Treasury and IRS also issued a revenue procedure that exempts floating NAV money market funds from the wash sale rules completely, as ICI requested. [\[5\]](#)

### **Accounting Implications of Floating NAV Money Market Funds**

It is the SEC’s position that, under normal circumstances, an investment in a floating NAV money market fund meets the definition of a “cash equivalent” for purposes of U.S. GAAP. If events occur that give rise to credit and liquidity issues for money market funds, however, the Release states that shareholders would need to reassess if their investments in that money market fund continue to meet the definition of a cash equivalent.

## **Fees and Gates for Non-Government Money Market Funds**

The amendments give money market fund boards new tools to stem heavy redemptions by giving them discretion to impose a liquidity fee or gate if a fund’s weekly liquid assets fall below the required regulatory threshold. The amendments also require all non-government money market funds (including floating NAV money market funds) to impose a liquidity fee if the fund’s weekly liquid assets fall below a designated threshold, unless the fund’s board determines that imposing such a fee is not in the best interests of the fund. The Release explains that fees and gates are intended to enhance money market funds’ ability to manage and mitigate potential contagion from high levels of redemptions and make redeeming investors pay their share of the costs of the liquidity that they receive. The SEC acknowledges, however, that fees and gates will rarely be imposed during normal market conditions.

### **Imposition of Fees and/or Gates**

The new rules allow a money market fund the flexibility to impose fees (up to 2 percent) and/or gates (up to 10 business days in a 90-day period) after the fund’s weekly liquid assets have crossed below 30 percent of its total assets, if the fund’s board of directors (including a majority of its independent directors) determines that doing so is in the best interests of the fund. The Release makes clear that when determining whether a fund has been gated for more than 10 business days in a 90-day period, the fund should account for any multiple separate gating periods and assess compliance with the 90-day limit on a rolling basis, calculated daily. [\[6\]](#)

The new rules also require a non-government money market fund, if its weekly liquid assets fall below 10 percent of its total assets, to impose a 1 percent liquidity fee on each shareholder’s redemption, [\[7\]](#) unless the fund’s board (including a majority of its

independent directors) determines that such a fee would not be in the best interests of the fund, or determines that a lower or higher (not to exceed 2 percent) fee would be in the best interests of the fund. The Release explains that the 10 percent default liquidity fee threshold is designed effectively as a floor to require fund boards to focus on a fund's liquidity and to consider what action to take, if any, before liquidity is further depleted.

The proposal would have required non-government money market funds (absent a board determination otherwise) to impose a 2 percent liquidity fee on all redemptions, and would have permitted the imposition of redemption gates for up to 30 days in a 90 day period, after a fund's weekly liquid assets fell below 15 percent of its total assets. In addition, unlike in the proposal, the new rules allow a fund to impose a fee or gate at any point throughout the day after a fund's weekly liquid assets have dropped below 30 percent.

## **Removal of Fees and/or Gates**

Any fee or gate must be lifted automatically after the money market fund's level of weekly liquid assets rises to or above 30 percent, but can be lifted or altered at any time before that point if the board (including a majority of independent directors) determines that imposing such liquidity fee or gate is no longer in the best interests of the fund.

## **Board Factors**

The SEC lists a number of factors a board may want to consider, as applicable and appropriate, when determining whether a fund should impose fees or gates. [\[8\]](#) It also provides a list of factors a board may want to consider in determining the level of a liquidity fee. [\[9\]](#)

## **Government Money Market Funds**

Importantly, government money market funds are not subject to the new fees and gates provisions although these funds can voluntarily opt into them, if previously disclosed to investors. Indeed, the Release notes that although government money market funds may opt-in to fees and gates, the SEC expects these funds will rarely impose fees and gates because their portfolio assets present little credit risk.

## **Feeder Funds**

Under the amendments, a feeder fund in a master/feeder structure, is not allowed to independently impose a fee or gate, but rather is required to pass through to its investors a fee or gate imposed by the master fund in which it invests.

## **Amendments to Rule 22e-3**

Currently, Rule 22e-3 allows a money market fund to permanently suspend redemptions and liquidate if the fund's board determines that the deviation between the fund's amortized cost price per share and its market-based NAV per share may result in material dilution or unfair results to investors or existing shareholders. The amendments to Rule 22e-3 also permit a money market fund to permanently suspend redemptions and liquidate if the fund's level of weekly liquid assets falls below 10 percent of its total assets.

## **Tax Implications of Fees**

The Release notes that for federal income tax purposes, shareholders of mutual funds that impose a redemption fee pursuant to Rule 22c-2 generally treat the redemption fee as offsetting the shareholder's amount realized on the redemption (decreasing the shareholder's gain, or increasing the shareholder's loss, on redemption). As a result, funds generally treat the redemption fee as having no associated tax effect for the fund.

According to the Release, the SEC understands that a liquidity fee will be treated for federal income tax purposes consistently with the way that funds and shareholders currently treat redemption fees under Rule 22c-2.

## **Accounting Implications of Fees and Gates**

It is the SEC's position that, under normal circumstances, an investment in a money market fund that has the ability to impose a fee or a gate under Rule 2a-7 qualifies as a "cash equivalent" for purposes of U.S. GAAP. On the other hand, the Release cautions that if events occur that give rise to credit and liquidity issues for money market funds, including the imposition of a fee or gate, shareholders would need to reassess if their investments in that money market fund continue to meet the definition of a cash equivalent.

## **Application of Fees and Gates to Other Types of Funds**

**ERISA and Other Tax-Exempt Plans:** The Release notes concerns raised by some commenters regarding the application of fees and gates to funds offered in ERISA and/or other tax-exempt plans. In response to these concerns, the SEC consulted with the Department of Labor's Employee Benefits Security Administration regarding potential issues under ERISA. The Release provides a summary of that consultation. [\[10\]](#)

**Insurance Funds:** For money market funds held through insurance company separate accounts, the Release clarifies that the fees and gates amendments apply to such funds. [\[11\]](#)

## **Guidance on Amortized Cost and Other Valuation Concerns**

As noted above, the final rules will permit stable NAV money market funds (i.e., government and retail money market funds) to maintain a stable NAV by using amortized cost valuation and/or the penny rounding method of pricing. In addition, all other registered investment companies (including floating NAV money market funds) and business development companies may, in accordance with SEC guidance, continue to use amortized cost to value debt securities with remaining maturities of 60 days or less if fund directors, in good faith, determine that the fair value of the debt securities is their amortized cost value, unless the particular circumstances warrant otherwise. To help advance the goals of its money market fund reform rulemaking, the SEC has provided expanded valuation guidance on the use of amortized cost valuation as well as other related valuation issues. [\[12\]](#)

## **Use of Amortized Cost Valuation**

According to the Release, "a fund may only use the amortized cost method to value a portfolio security with a remaining maturity of 60 days or less when it can reasonably conclude, at each time it makes a valuation determination, that the amortized cost value of the portfolio security is approximately the same as the fair value of the security as determined without the use of amortized cost valuation. Existing credit, liquidity, or interest rate conditions in the relevant markets and issuer specific circumstances at each such time should be taken into account in making such an evaluation." [\[13\]](#)

Further, because each money market fund will be required to value, on a daily basis, the fund's portfolio securities using market-based factors and disclose the fund's share price using basis point rounding, the SEC believes that each money market fund should have readily available market-based data to assist it in monitoring any potential deviation



between a security's amortized cost and fair value determined using market-based factors. In certain circumstances (e.g., intraday), the Release notes that a fund may rely on the last obtained market-based data to assist it when valuing its portfolio securities using amortized cost. To address this, a fund's policies and procedures could be designed to ensure that the fund's adviser is actively monitoring both market and issuer-specific developments that may indicate that the market-based fair value of a portfolio security has changed during the day indicating the use of amortized cost valuation for that security may no longer be appropriate.

## **Other Valuation Matters**

The Release acknowledges that the vast majority of money market fund portfolio securities (e.g., commercial paper, repos, CDs) are valued largely based upon "mark-to-model" or "matrix pricing" estimates because these securities are not actively traded in the secondary markets. In response to comments regarding the utility of market-based valuation, the Release sets forth guidance regarding the fair value of thinly traded securities and the use of pricing services in valuing such securities. [\[14\]](#) Notably, the Release states that funds holding debt securities generally should not fair value these securities at par or amortized cost based on the expectation that the funds will hold those securities until maturity, if the funds could not reasonably expect to receive approximately that value upon the current sale of those securities under current market conditions. With respect to use of pricing services, the Release suggests that before deciding to use evaluated prices from a pricing service to assist it in determining the fair values of a fund's portfolio securities, the fund's board may want to consider the inputs, methods, models, and assumptions used by the pricing service to determine its evaluated prices, and how those inputs, methods, models, and assumptions are affected (if at all) as market conditions change.

## **Disclosure and Reporting**

The new disclosure rules are designed to improve transparency related to money market funds' operations, their overall risk profile, and any affiliate financial support during the last 10 years (but not for occasions that occurred before the compliance date). The final rules amend rule and form provisions applicable to various disclosure documents, including disclosures in money market funds' advertisements, the summary section of the prospectus, and the statement of additional information.

### **Website Disclosure**

The amended rules require money market funds to disclose daily (and to provide six months of historical information) on their website the levels of daily and weekly liquid assets, net shareholder inflows and outflows, and market-based NAVs using basis point rounding. In addition, the imposition and/or removal of fees and/or gates and any use of sponsor support that a fund is required to report to the SEC in an initial report on Form N-CR (discussed below) also must be disclosed on a fund's website.

### **Form N-CR**

The amendments require funds to promptly disclose certain significant events on new Form N-CR within one business day of the triggering event. These events include: portfolio security defaults; sponsor or fund affiliate support (including the amount of and reason for); the imposition or removal of liquidity fees and/or gates; and for retail and government money market funds, a decline in the fund's market-based NAV per share below \$0.9975. A money market fund also must submit a follow-up filing within four business days that

includes a more complete description and information about the reported event(s).

In response to concerns by commenters, including ICI, that the proposed definition of sponsor support was ambiguous and could trigger unnecessary filings, the final amendments clarify that certain routine actions, and actions not reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio, do not need to be reported as financial support on Form N-CR. As adopted, the term "financial support" includes any: capital contribution; purchase of a security from the fund in reliance on Rule 17a-9; purchase of any defaulted or devalued security at par; execution of letter of credit or letter of indemnity; capital support agreement (whether or not the fund ultimately received support); performance guarantee; or any similar action reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio, excluding, however, any: routine fee waiver or expense reimbursement; routine inter-fund lending; routine inter-fund purchases of fund shares; or any action that would qualify as financial support that the board has otherwise determined not to be reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio.

### **Form N-MFP Amendments**

The amendments to Form N-MFP require reporting of additional information relevant to assessing money market fund risk. These include: the reporting of a money market fund's NAV per share (and shadow price); daily and weekly liquid assets; and shareholder flows on a weekly basis within the monthly filing of the form. The amended Form also requires information about fee waivers during a given reporting period. In response to comments received, including those from ICI, the final form amendments do not include the reporting of lot level security and shareholder concentration reporting requirements. In addition, Form N-MFP will be publicly available immediately upon filing (rather than the current 60-day delay).

### **Form PF**

Amendments to Form PF require large liquidity fund advisers—registered advisers with \$1 billion or more in combined money market fund and liquidity fund assets—to file quarterly (broken down by month) virtually the same information with respect to their liquidity funds' portfolio holdings on Form PF as money market funds are required to file on Form N-MFP. Consistent with current practice, the SEC does not intend to make Form PF information identifiable to any particular adviser or private fund.

## **Diversification Requirements**

The amendments to the Rule 2a-7 diversification provisions were adopted largely as proposed.

### **Aggregation of Affiliates**

The amendments require money market funds to limit their exposure to affiliated groups, rather than to discrete issuers. Specifically, money market funds must treat certain affiliated entities as single issuers when applying Rule 2a-7's 5 percent issuer diversification limit. Entities are affiliated with one another if one controls the other entity or is controlled by it or is under common control with it. Control for this purpose is defined to mean ownership of more than 50 percent of an entity's voting securities. The amended diversification provisions exclude certain majority equity owners of asset-backed commercial paper conduits from the requirement to aggregate affiliates. The Release explains that voting equity of an ABCP conduit is typically almost entirely owned by an



otherwise unaffiliated third party that is in the business of owning such entities and providing management and administrative services, and not by the ABCP conduit sponsor. Requiring money market funds to aggregate conduits on the basis of common equity ownership, therefore, would unnecessarily restrict the amount of ABCP available for purchase by money market funds.

## **Asset-Backed Securities**

The amendments require money market funds to treat the sponsors of asset-backed securities as guarantors subject to Rule 2a-7's 10 percent diversification limit applicable to guarantees and demand features, unless the fund's board (or its delegate) determines that the fund is not relying on the sponsor's financial strength or its ability or willingness to provide liquidity, credit, or other support to determine the ABS's quality or liquidity.

The Release notes that for ABCP, the sponsor will typically be the financial institution that provides explicit liquidity and/or credit support and also provides administrative services to the ABCP conduit. The SEC believes that for tender option bond programs in which the liquidity provider for the TOB program or its affiliate holds the residual interest in the TOB trust, the entity that provides both the liquidity support and holds the residual interest typically will be the sponsor. For TOB programs in which the liquidity provider or its affiliate also does not own the residual interest in the TOB trust, the SEC believes the financial institution that sets up the TOB program, markets and remarkets the TOBs, transfers the municipal security into the TOB trust and/or provides liquidity typically will be the sponsor.

In response to requests by many commenters to exclude certain types of ABS, including TOBs, from the amended rule, the SEC notes that the rule's rebuttable presumption allows for flexibility. For example, irrespective of the actual type of ABS, a fund's board may determine the fund is not relying on the sponsor to make determinations about quality or liquidity.

## **The 25 Percent Basket**

Currently, as much as 25 percent of the value of securities held in a money market fund's portfolio may be subject to guarantees or demand features from a single institution. Citing events that highlighted the risks to money market funds caused by their substantial exposure to providers of demand features and guarantees, the amendments remove the 25 percent basket for money market funds other than tax exempt money market funds and reduce to 15 percent, rather than eliminate (as proposed) the 25 percent basket for tax exempt money market funds, including single state money market funds. [\[15\]](#) The SEC is concerned that removing the 25 percent basket entirely for tax exempt money market funds (which have more limited availability of credit support providers compared to taxable money market funds) would inhibit the ability of these funds to be fully invested in securities subject to guarantees or demand features or may force them to invest in securities that have weaker credit than the securities they might otherwise purchase.

## **Stress Testing**

The amendments enhance the stress testing requirements adopted by the SEC in 2010. Specifically, the new rules require funds periodically to test their ability to maintain weekly liquid assets of at least 10 percent (proposed to be 15 percent) and to minimize principal volatility (and, for stable NAV money market funds, the fund's ability to maintain a stable price per share) in response to specified hypothetical events that include (i) increases in the level of short term interest rates, (ii) the downgrade or default of particular portfolio

security positions, each representing various exposures in a fund's portfolio, and (iii) the widening of spreads in various sectors to which the fund's portfolio is exposed, each in combination with various increases in shareholder redemptions. The fund's adviser must report the results of the stress testing to the board, including any information as may be reasonably necessary for the board of directors to evaluate the stress testing results.

According to the Release, the SEC staff has monitored the current stress testing requirement and how different fund groups have approached its implementation in the marketplace. Based on these examinations, the staff observed disparities in the quality and comprehensiveness of stress tests, the hypothetical circumstances tested, and the effectiveness of materials produced by fund managers to explain the stress testing results to boards. For example, some funds test for combinations of events, as well as for correlations between events and between portfolio holdings, whereas others do not. The final rules reflect the SEC's belief that an evaluation of combinations of events and correlations among portfolio holdings is an important part of a fund's stress testing.

In addition to a requirement that funds test their liquidity levels, the final rules are modified from the proposal to require all money market funds, including floating NAV funds, to test their NAV stability. This change was made because several commenters argued that investors in floating NAV funds will continue to expect a relatively stable NAV. The SEC determined, however, not to set specific limitations or thresholds against which funds should test principal volatility because it believes that funds and fund boards are best suited to determine the amount of principal volatility that investors in their floating NAV funds will likely tolerate and, accordingly, what volatility threshold or thresholds should be used in their stress testing.

The final rules eliminate the proposed requirement that funds report the "magnitude of each hypothetical event" that would cause the fund to fall below the liquidity threshold. According to the Release, this change responds to commenters' (including ICI) concerns that making such a determination is not feasible. Also in response to commenters' concerns, the modified rule text clarifies the number and extent of hypothetical event tests that the rule requires. Indeed, the Release acknowledges that, as proposed, some of the hypothetical events were vague and might be difficult to implement. To address these concerns, the final rule reflects the four primary areas of risk that can place stress on funds. Those are: (i) an increase in the general level of short-term interest rates; (ii) a downgrade or default of a portfolio security position; (iii) a correlated increase in the credit spreads for certain portfolio securities; and (iv) an increase in shareholder redemptions. The SEC believes that requiring each fund to test each of the first three events in combination with increasing shareholder redemptions will provide the most meaningful results to boards, while reducing the number of combinations of events that the rule requires as a minimum set for stress testing. The final rule also clarifies that a fund is only required to test for additional combinations as the fund adviser deems relevant, not for combinations of every permutation of the events listed in the rule.

## **Compliance Dates**

The compliance dates for the amendments are as follows:

- Floating NAV and Fees/Gates: Two years after the date of publication of the Release in the Federal Register.
- New Form N-CR: Nine months after the date of publication of the Release in the

Federal Register.

- Diversification, Stress Testing, Disclosure, Form PF, Form N-MFP and Clarifying Amendments: 18 months after the date of publication of the Release in the Federal Register.

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#### **endnotes**

[1] Money Market Fund Reform; Amendments to Form PF, SEC Release No. IC-31166 (July 23, 2014) (“Release”), which is available at <http://www.sec.gov/rules/final/2014/33-9616.pdf>.

[2] The proposed exemptive order is available at <http://www.sec.gov/rules/exorders/2014/34-72658.pdf>.

[3] The repropoed amendments are available at <http://www.sec.gov/rules/proposed/2014/ic-31184.pdf>.

[4] See also Investment Company Act Rule 38a-1(a)(3) (compliance program rule for investment companies).

[5] For a memorandum describing the Treasury and IRS guidance regarding floating NAV money market funds, see ICI Memorandum (28281), dated July 24, 2014, available at [http://www.ici.org/my\\_ici/memorandum/memo28281](http://www.ici.org/my_ici/memorandum/memo28281).

[6] Release at 109.

[7] The proposal contemplated that a liquidity fee would be applied on a net basis (rather than applied to each redemption separately). In light of ICI comments suggesting that a net basis approach may be too operationally difficult and costly for funds to apply, the new rules recognize that a liquidity fee could either be applied to each redemption separately or on a net basis.

[8] Release at 88-89.

[9] Release at 98.

[10] See Release at 265-268.

[11] See Release at 268-270.

[12] See Release at 270-281.

[13] Release at 273.

[14] See Release at 275-281.

[15] We note that the amended rule text is somewhat confusing and may not accurately reflect the SEC’s intent to retain a 15 percent basket for tax exempt money market funds. Compare new provisions in Rule 2a-7(d)(3)(i) with (d)(3)(iii).

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