

**MEMO# 27287**

June 10, 2013

## **SEC Proposes Money Market Fund Reform**

[27287]

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 17-13  
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 15-13  
BROKER/DEALER ADVISORY COMMITTEE No. 28-13  
INVESTMENT COMPANY DIRECTORS No. 9-13  
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 13-13  
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 12-13  
OPERATIONS COMMITTEE No. 25-13  
SEC RULES COMMITTEE No. 25-13  
SMALL FUNDS COMMITTEE No. 12-13  
TRANSFER AGENT ADVISORY COMMITTEE No. 43-13 RE: SEC PROPOSES MONEY MARKET FUND REFORM

The Securities and Exchange Commission recently unanimously voted to propose for public comment two alternatives for amending Rule 2a-7 and other rules that govern money market funds under the Investment Company Act of 1940. [\[1\]](#) According to the release, the two alternatives, which could be adopted alone or in combination, are designed to address money market fund's susceptibility to heavy redemptions, 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, the benefits of money market funds. The SEC requests comment on all aspects of its proposal. Comments are due 90 days after publication in the Federal Register. A summary of the SEC's 698 page proposal follows.

### **Alternative One: Floating NAV**

Under the first alternative, prime and tax exempt institutional money market funds would be required to float their net asset value (NAV). Specifically, these funds must sell and redeem shares based on the current market-based value of the securities in their underlying portfolios and "basis point round" their share price to the nearest 1/100th of one percent (the fourth decimal place in the case of a fund with a \$1.0000 share price). These funds will be permitted to use amortized cost to the same extent as other mutual funds, i.e., for securities maturing in 60 days or less; however, the accuracy of "basis point" rounding is 10 times that required for other mutual funds.

According to the release, the floating NAV alternative is designed primarily to address the heightened incentive shareholders have to redeem shares in times of financial stress. It also is intended to improve the transparency of money market fund risks through more visible valuation and pricing methods.

#### U.S. Government and Retail Money Market Fund Exemptions

U.S. government money market funds (including Treasury money market funds) and retail money market funds would be allowed to continue using the penny rounding method of pricing (but not the amortized cost method of valuation for securities maturing in more than 60 days) to maintain a stable share price. According to the release, the SEC does not believe that allowing continued use of amortized cost valuation for all securities in money market funds' portfolios is appropriate given that these funds will already be valuing their securities using market factors on a daily basis due to new website disclosure requirements (discussed below) and given that penny rounding otherwise achieves the same level of price stability.

A government money market fund would be defined as any money market fund that holds at least 80 percent of its assets in cash, U.S. government securities, or repurchase agreements collateralized with government securities.

A retail money market fund would be defined as a money market fund that limits each shareholder of record from redeeming more than \$1 million per business day. With respect to the \$1 million redemption limit, the SEC requests commenters with access to shareholder redemption data to provide it with detailed information about the size of individual redemptions in normal market periods, as well as during other times, such as September 2008 and summer 2011. The release also suggests that because tax exempt money market funds are not required to maintain 10 percent daily liquid assets, these funds may be less liquid than other retail money market funds and not able to manage even the lower level of redemptions expected in a retail fund. The SEC requests comment on whether it should require tax exempt funds that wish to take advantage of the proposed retail exemption also to meet the 10 percent daily liquid asset requirements.

The release acknowledges that applying the daily redemption limitation method to omnibus accounts may pose difficulties. Under the proposal, to qualify as a retail fund, a fund would be required to restrict daily redemptions by omnibus accounts to no more than \$1 million. Alternatively, omnibus accounts would be permitted to exceed the \$1 million limit provided the fund has policies and procedures reasonably designed to conclude that the omnibus account holder does not permit any beneficial owner from "directly or indirectly" redeeming more than \$1 million in a single day. The release explains that the restriction on "direct or indirect" redemptions is designed to manage issues related to "chains of intermediaries," such as when an investor purchases fund shares through one intermediary (e.g., an introducing broker or retirement plan), which then purchases the fund shares through a second intermediary (e.g., a clearing broker). The fund must reasonably conclude that the redemption limitation is applied to beneficial owners all the way down any chain of intermediaries. If a fund cannot reasonably conclude that such policies are enforced by intermediaries at each step of the chain, then the fund must apply its redemption limit at the aggregate omnibus account holder level (or rely on a cooperating intermediary to apply the redemption limits further down the chain). The proposed rule would not require retail money market funds to enter into explicit agreements or contracts with omnibus account holders at any stage in the chain, but would instead allow funds to manage these relations in whatever way that best suits their circumstances.

The release also discusses several alternate methods that could be used to distinguish between retail and institutional funds, such as maximum account balance, shareholder concentration, and shareholder characteristics and requests comment on each of these alternative approaches.

### Tax Implications of a Floating NAV

The release acknowledges the potential increased tax-compliance burdens associated with a floating NAV for both money market funds and shareholders (e.g., tracking of gains and losses, cost-basis reporting). To this end, the release notes that discussions with staff at the Treasury Department and the IRS have suggested that money market funds that float their NAV per share would no longer be excluded from the information reporting requirements currently applicable to other mutual funds and intermediaries. To reduce some of these burdens, the release states that the Treasury Department and the IRS are considering alternatives for modifying forms and guidance (1) to include net information reporting by the funds of realized gains and losses for sales of all money market fund shares and (2) to allow summary income tax reporting by shareholders. The release acknowledges, however, that even with this relief, all floating NAV fund shareholders would be required to recognize and report taxable gains and losses with respect to redemptions of fund shares, which does not occur today with respect to stable-value money market funds.

In addition to the tax obligations that may rise through daily fluctuations in purchase and redemption prices of floating NAV money market funds, the release notes that special “wash sale” rules apply when shareholders sell securities at a loss and, within 30 days before or after the sale, buy substantially identical securities. The release explains that if a shareholder incurs a loss from a wash sale, the loss cannot be deducted, and instead must be added to the basis of the new, substantially identical securities, which effectively postpones the loss deduction until the shareholder recognizes a gain or loss on the new securities. Because many money market fund investors automatically reinvest their dividends (which are often paid monthly), virtually all redemptions by these investors would be within 30 days of a dividend reinvestment (i.e., purchase). To mitigate this burden, the release notes the Treasury Department and the IRS are actively considering administrative relief under which redemptions of floating NAV money market fund shares that generate losses below a de minimis threshold would not be subject to the wash sale rule. The SEC recognizes, however, that funds would still incur operational costs to establish systems with the capability of identifying wash sale transactions, assessing whether they meet the de minimis criterion, and adjusting shareholder basis as needed when they do not.

The release requests comment on the tax implications of its floating NAV proposal.

### Accounting Implications of a Floating NAV

According to the release, the SEC believes that an investment in a floating NAV money market fund would still meet the definition of a “cash equivalent” under GAAP. Citing the SEC staff’s November study as support, the release states that the “adoption of floating NAV alone would not preclude shareholders from classifying their investments in money market funds as cash equivalents because fluctuations in the amount of cash received upon redemption would likely be insignificant.” The release notes that if events occur that cause shareholders in floating NAV funds to determine their shares are not cash equivalents, the shares would need to be classified as investments and treated as either trading securities or available-for-sale securities. The release requests comment on whether commenters believe a floating NAV would preclude money market funds from being classified as cash

equivalents under GAAP and whether there are any other accounting-related costs or burdens associated with a floating NAV.

### Operational Implications of a Floating NAV

The release acknowledges that funds, transfer agents, intermediaries, and others in the distribution chain may not currently have the capacity to process transactions for floating NAVs on a continuous basis and that controls and procedures for the accounting systems at these entities would have to be modified to permit those systems to calculate a fund's floating NAV daily and to communicate that value to others in the distribution chain. The release notes that funds and other recordkeepers would incur additional costs to track portfolio security gains and losses, provide "basis reporting" and monitor for potential wash-sale transactions. The release also acknowledges the potential costs and difficulties of providing same-day settlement for floating NAV funds. In addition to funds and other entities in the distribution chain, the release notes that money market fund shareholders would likely be required to modify their own systems to accommodate a floating NAV.

The release requests comment on the SEC's analysis of the nature and extent of the costs funds, transfer agents, intermediaries and shareholders would incur to modify procedures, control, and systems associated with implementing a floating NAV.

### Disclosure Regarding Floating NAV

The proposal would require disclosure-related amendments to Rule 482 under the Securities Act of 1933 and Form N-1A in connection with the particular risks of a floating NAV fund (e.g., the value of fund securities will increase and decrease as a result of changes in the value of the securities in which the fund invests). The proposal anticipates that the new disclosure would be in the summary section of the statutory prospectus with more detailed information provided elsewhere in the prospectus and in the statement of additional information (SAI).

### Affiliate Purchases

Under the proposal, fund sponsors would be allowed to continue to support money market fund operations through, for example, affiliate purchases (pursuant to Rule 17a-9), provided such support is thoroughly and consistently disclosed (as discussed below).

### Suspension of redemptions

The proposal would preserve the benefits of Rule 22e-3 by permitting floating NAV money market funds to suspend redemptions and liquidate, when among other requirements, the fund, at the end of a business day, has less than 15 percent of its total assets in weekly liquid assets. Government and retail money market funds would be able to suspend redemptions and liquidate if either the fund, at the end of a business day, has less than 15 percent of its total assets in weekly liquid assets or was about to break the dollar.

### Confirmation Statements

Rule 10b-10 under the Securities Exchange Act of 1934 addresses broker-dealers' obligations to confirm their customers' securities transactions. The rule provides an exception for transactions in stable NAV money market funds and where no sales load or redemption fee is charged. The rule permits a broker-dealer to provide transaction information to fund shareholders on a monthly basis in lieu of individual, immediate

confirmations for all purchases and redemptions of shares of these money market funds.

The SEC requests comment on whether it should leave the confirmation rule unchanged if it adopts the floating NAV requirement, which would have the effect of requiring broker-dealers to provide fund investors immediate confirmations of their transactions.

## Transition

The SEC proposes that it delay compliance with the floating NAV requirement for a period of 2 years from the effective date of its proposed rulemaking. Money market funds subject to the floating NAV requirement could continue to price their shares as they do today for up to 2 years following this date. On or before the compliance date, all stable value money market funds not exempted from the floating NAV proposal would convert to a floating NAV.

## **Alternative Two: Standby Liquidity Fees and Gates**

Under the second alternative, all money market funds would continue to transact at a stable, penny-rounded price (but not an amortized price for securities maturing in more than 60 days for the same reasons noted above for the government and retail exemptions to the floating NAV alternative), but in certain circumstances would be required to institute a liquidity fee and permitted to impose a redemption gate in times of stress. Based on his comments at the open meeting, Commissioner Paredes favors the fees and gates alternative; however, he will be leaving the SEC before any final rule will be voted upon.

The release explains that the fees and gates alternative is designed to address the contagion effects of heavy redemptions in money market funds that had a significant impact on investors, funds, and the markets during the financial crisis. Regardless of the incentives to redeem, the release notes that a liquidity fee would make redeeming investors pay for the costs of liquidity and, if investors continue to redeem from a fund, gates can directly respond to a run by halting redemptions. The SEC explains that it is proposing a fee as the initial default (rather than imposing a gate as the default) because it believes that a fee has the potential to be less disruptive to fund shareholders and the short-term financing markets because a fee allows fund shareholders to continue to transact in times of stress (although at a cost). At the same time, if the board determines that a fee is insufficient to protect the interests of non-redeeming shareholders, it still has the option of imposing a gate. The release also explains that the SEC is proposing a default liquidity fee of a pre-determined size of 2 percent that the money market fund's board can modify or remove if it is in the best interests of the fund because this structure offers the possibility of achieving many of the benefits of both full discretionary and automatic (regulatory mandated) redemption restriction triggers. The release notes that liquidity fees and gates have been successfully used in the past by certain non-money market fund cash management pools to stem redemptions during times of stress.

## Liquidity Fees

If a money market fund's level of "weekly liquid assets" were to fall below 15 percent of its total assets (half the required amount), the money market fund would have to impose a 2 percent liquidity fee on all redemptions. Such a fee would not be imposed, however, if the fund's board of directors determines that the fee is not in the best interest of the fund or that a lesser liquidity fee is in the best interest of the fund. The release requests comment on all aspects of the liquidity fee, including the application of liquidity fees to shares held through omnibus accounts.

## Redemption Gates

Under alternative two, once a money market fund's weekly liquid assets fall below 15 percent of total assets, its board of directors also would be able to impose a temporary suspension of redemptions (or "gate"). A money market fund that imposes a gate would need to lift that gate within 30 days, although the board of directors could determine to lift the gate earlier. Money market funds would not be able to impose a gate for more than 30 days in any 90-day period.

## Exemption for Government Money Market Funds

U.S. government money market funds (including Treasury money market funds) would be exempt from the fees and gates requirement; however, these funds could voluntarily opt into this new requirement. Retail money market funds would not be exempt from the fees and gates alternative.

## Operational Considerations of Fees and Gates

The release acknowledges that money market funds and others in the distribution chain likely would incur operational costs in establishing or modifying systems to administer a liquidity fee or gate. These costs would vary depending on how a liquidity fee or gate is structured, including its triggering event, as well as the capabilities, functions, and sophistication of the fund's and others' current systems. The release provides a range of estimated costs associated with the fees and gates alternative and also requests comment on its estimate of operational costs associated with this proposal.

## Tax Implications of Liquidity Fees

It is the SEC's understanding that liquidity fees, if adopted, would be treated for tax purposes consistently with the way that funds and shareholders treat redemption fees under Rule 22c-2, i.e., redemption fees offset the shareholder's amount realized on the redemption (decreasing the shareholder's gain, or increasing the shareholder's loss, on redemption) and has no associated tax effect for the fund. If the liquidity fee has no tax consequences for the fund, the fund could use 100 percent of the fee to repair its NAV that was below a \$1.00. If redemptions involving liquidity fees cause the fund's shadow price to reach \$1.0050, however, the fund may need to distribute to the remaining shareholders sufficient value to prevent the fund from breaking the dollar (and thus rounding up to \$1.01 in pricing its shares). This distribution would be treated as a dividend to the extent that the money market fund has sufficient earnings and profits. In the absence of sufficient earnings and profits, however, some or all of these additional distributions would be treated as a return of capital, which would reduce the recipient shareholders' basis. Thus, in the event of any return of capital distributions, the shareholders, the fund, and other intermediaries might become subject to tax-payment or tax-reporting obligations that do not affect stable NAV funds currently.

## Disclosure Regarding Fees and Gates

The proposal would require money market funds to make additional disclosures pursuant to Rule 482 and Form N-1A relating to, among other things, the particular risks (as well as the effects on redemptions) associated with investing in a fund that may impose liquidity fees or redemption restrictions in any advertisement or sales material that it disseminates. Funds also would be required to include SAI disclosure regarding all historical occasions in

which the fund's weekly liquid assets have fallen below 15 percent or the fund has imposed liquidity fees or redemption gates.

#### Prompt Public Disclosure of Imposition of Fees and Gates

Money market funds would be required to promptly and publicly disclose on its website (and in prospectus supplements) the fund crossing of the 15 percent weekly liquid asset threshold, the imposition and removal of any liquidity fee or gate, and a discussion of the board's analysis in determining whether or not to impose a fee or gate. This information also would be reported to the SEC on new Form N-CR (see discussion below).

### **Potential Combination of Alternative One and Two**

The SEC also is considering whether to combine the floating NAV and the liquidity fees and gates proposals into a single reform package. If adopted, prime and tax exempt institutional money market fund would be required to transact at a floating NAV and all non-government funds would be able to impose liquidity fees or gates in certain circumstances. The SEC requests public comments on the benefits and drawbacks of a single reform approach. Based on their comments at the open meeting, Commissioners White, Gallagher, and Walter appear to support such a combination, and the SEC staff also appeared to favor this approach.

### **Enhanced Disclosure requirements**

In addition to requiring certain disclosures relating to the floating NAV and fees and gates proposals as noted above, the proposal seeks to improve the transparency of money market fund operations and risks.

#### Website Disclosure

Money market funds would be required to disclose on their website, on a daily basis, their levels of daily and weekly liquid assets, the fund's net inflows and outflows, and market-based NAVs per share, as well as any events reported on Form N-CR (a new form, discussed below).

The proposal also would harmonize the specific portfolio holdings information that Rule 2a-7 currently requires funds to disclose on their websites with the corresponding portfolio holdings information proposed to be reported on Form N-MFP pursuant to proposed amendments to that form.

In addition, the release requests comment about whether the SEC should require money market funds to disclose on their websites more frequently than monthly their portfolio holdings, including the market value of individual portfolio securities.

#### New Material Event Disclosure

Money market funds would be required to promptly disclose (within one business day) certain events on a new form (Form N-CR). These events would include the imposition or lifting of fees or gates, portfolio security defaults, sponsor support, and—for funds that would continue to maintain a stable share price under either alternative—a fall in the fund's market based NAV per share below \$0.9975.

#### Disclosure of Sponsor Support

Money market funds would be required to provide SAI disclosure regarding historic instances in which the fund has received financial support (including the details of that support) from a sponsor or an affiliate within the last ten years (in addition to the current event disclosures required on Form N-CR). “Financial support” is defined to include (i) any capital contribution, (ii) purchase of a security from a fund in reliance on Rule 17a-9, (iii) purchase of any defaulted or devalued security at par, (iv) purchase of fund shares, (v) execution of a letter of credit or letter of indemnity, (vi) capital support agreement (whether or not the fund ultimately received support), (vii) performance guarantee, or (viii) any other similar action to increase the value of the fund’s portfolio or otherwise support the fund during times of stress.

## **Amendments to Form N-MFP Reporting Requirements**

Under the proposal, Form N-MFP would be amended to clarify existing requirements and require reporting of additional information relevant to assessing money market fund risk. Although funds would continue to file reports on Form N-MFP once each month (as they do today), certain limited information (such as the NAV per share, daily liquid assets, weekly liquid assets, and shareholder flow) would be reported on a weekly basis. In addition, the proposal would eliminate the current 60-day delay on public availability of the information filed on the form and would make it public immediately upon filing.

The SEC also requests comment on whether it should increase the frequency of filing Form N-MFP from monthly to weekly.

## **Amendments to Form PF**

To better monitor whether substantial assets migrate to liquidity funds in response to money market fund reforms, the proposal would amend Form PF, which private fund advisers use to report information about certain private funds they advise.

The proposed changes would require a “large liquidity fund adviser” (a liquidity fund adviser managing at least \$1 billion in combined money market fund and liquidity fund (e.g., unregistered money funds) assets) to report quarterly (with the information broken out monthly) substantially the same portfolio information on Form PF as registered money market funds would report on Form N-MFP. In recognition of the sensitivity of some of the data collected on Form PF (e.g., hedge fund holdings), the SEC does not intend to make public Form PF information identifiable to any particular adviser or private fund.

## **Stronger Diversification Requirements**

The proposal includes the following proposed changes to the diversification requirements of money market funds’ portfolios:

### **Aggregation of Affiliates**

Money market funds would be required to aggregate affiliates for purposes of determining whether they are complying with money market funds’ 5 percent issuer diversification limit. The release explains that although affiliates may be separate legal entities, their valuations and the creditworthiness of their securities may depend on the financial well-being of other firms in the group.

Under this limitation, a fund may not invest any more than 5 percent of its assets in any one issuer. Entities would be affiliated for this purpose if one controlled the other entity or was controlled by it or under common control with it. For this purpose only, “control” would be defined to mean ownership of more than 50 percent of an entity’s voting securities.



According to the release, the SEC believes that money market funds generally would be able to determine issuer affiliations, defined with a majority ownership test, as part of their evaluation of whether a security presents minimal credit risks, or that money market funds could readily obtain this information from issuers or the broker-dealers marketing the issuance. The SEC requests comment on all aspects of this new diversification requirement.

### Asset-Backed Securities

According to the release, money market funds' reliance on and exposure to structured investment vehicle (SIV) sponsors in connection with SIVs' asset-backed commercial paper (ABCP) in 2007 suggests a potential weakness in the way in which Rule 2a-7's diversification provisions apply to asset-backed securities (ABS). This weakness potentially permits money market funds to become overexposed to sponsors of SIVs and ABS sponsors more generally. Specifically, the rule's current diversification provisions require no diversification of exposure to ABS sponsors because special purpose entities—rather than the sponsors themselves—issue the ABS, and the support that ABS sponsors provide, implicitly or explicitly, typically does not meet the rule's definition of guarantee or demand feature. Nonetheless, the release notes that money market funds investing in some types of ABCP rely on the ABCP sponsor for liquidity and other support and make investment decisions based, at least in part, on the presumption that the sponsor will take steps to prevent the ABCP from defaulting, including committing capital.

The proposal therefore amends Rule 2a-7's diversification provisions to limit the amount of exposure money market funds can have to ABS sponsors that provide support for their ABSs. Under the proposal, money market funds would need to aggregate all of the ABS vehicles sponsored by the same entity for purposes of the 10 percent guarantor diversification limit. This would not be necessary if a money market fund's board of directors determines the fund is not relying on the sponsor's strength or structural enhancements of the ABS in determining the quality or liquidity of the ABS.

### Removal of the 25 Percent Basket

The proposal also would tighten the diversification requirements applicable to guarantors and providers of demand features. The amendments would eliminate the so-called "25 percent basket" under which as much as 25 percent of the value of securities held in a fund's portfolio may be subject to guarantees or demand features from a single institution. The release explains that based on the staff's review of data filed on Form N-MFP, most money market funds do not use the 25 percent basket, and those funds that do use the basket, do not make significant use of it. Under the proposal, therefore, all of a money market fund's assets would need to meet the 10 percent diversification limits for guarantors and 'put' providers, thereby removing the 25 percent basket that permitted a single guarantor to guarantee 25 percent of a money market fund's assets.

Although the proposal would remove the 25 percent basket, the SEC is not proposing to change the application of Rule 2a-7's 5 percent issuer limit to single state funds, which today applies only to 75 percent of a single state fund's total assets.

### Additional Diversification Alternatives Considered

The release notes there are potentially other ways to make money market funds more diversified such as reducing Rule 2a-7's current 5 percent and 10 percent diversification

limits and/or imposing industry concentration limits. The release discusses the pros and cons of these alternative approaches and requests comment about whether the SEC should further restrict the diversification limits.

## **Issuer Transparency**

In 2008, monoline insurers that provided bond insurance to municipal issuers were downgraded, forcing some advisers to tax exempt money market funds to quickly obtain information about issuers of variable rate demand notes (VRDNs) and other municipal securities they held to determine whether the securities continued to present minimal credit risks (and whether to exercise demand features). In 2010, the SEC amended its rules to improve the transparency of information about VRDNs to investors by prohibiting broker-dealers from underwriting VRDNs unless the issuer had committed to ongoing information about itself and the securities, including financial data, through the MSRB's EMMA system. Compliance with issuers' continuing contractual disclosure obligations have been inconsistent, however, at times leaving money market fund and other investors exposed.

Currently, Rule 2a-7 permits a money market fund, when determining if a security subject to a guarantee meets the rule's credit quality standards, to rely exclusively on the credit quality of the guarantor. As a result of this and the rule's treatment of exposures to guarantors and demand feature providers for diversification purposes (the 10 percent limit on providers of guarantees and demand features compared to the 5 percent issuer limit), a money market fund can have greater indirect exposure to a guarantor than the fund could assume if it were investing in the guarantor directly, and may have minimal information about the issuer subject to the guarantee. As a result, the SEC requests comment about whether it should require money market funds to obtain financial data on the underlying issuers whose securities are subject to guarantees.

## **Enhanced Stress Testing**

Under the proposal, the stress testing requirements adopted by the SEC in 2010 would be further enhanced. In particular, a money market fund would be required to stress test against the fund's level of weekly liquid assets falling below 15 percent of total assets. In addition, the SEC is proposing to strengthen how money market funds stress test their portfolios and report the result of their stress tests to their boards of directors. For instance, the proposal would require that money market funds include factors such as correlations among securities' returns and concurrences of events in their stress tests.

## **Clarifying Amendments**

The SEC also proposes several clarifying amendments to address a number of questions that have arisen regarding the application of the 2010 amendments.

### **Definitions of Daily Liquid Assets and Weekly Liquid Assets**

The proposal would make clear that money market funds cannot use the maturity-shortening provisions in current paragraph (d) of Rule 2a-7 regarding interest rate readjustments when determining whether a security satisfies the maturity requirements of a daily liquid asset or weekly liquid asset. Using an interest rate readjustment to determine maturity as permitted under current paragraph (d) for these purposes would allow funds to include as daily and weekly liquid assets securities that the fund would not have a legal right to convert to cash in one or five business days.

The proposal also would require that an agency discount note with a remaining maturity of 60 days or less qualifies as a "weekly liquid asset" only if the note is issued without an

obligation to pay additional interest on the principal amount. The proposal would clarify that interest-bearing agency notes that are issued at a discount do not qualify. The SEC notes that although these types of agency notes are extremely rare, they were not among the agency discount notes that appeared to be relatively liquid during the 2008 market events and that it determined could qualify as weekly liquid assets.

The proposal also would include in the definitions of daily and weekly liquid assets amounts receivable that are due unconditionally within one or five business days, respectively, on pending sales of portfolio securities. These receivables, like certain other securities that qualify as daily or weekly liquid assets, provide liquidity for the fund because they give a fund the legal right to receive cash in one or five business days.

The release notes that the instruments that most, if not all, money market fund currently hold as daily and weekly liquid assets conform to the proposed amendments and these practices would be consistent with previous informal SEC staff guidance to money market funds. [\[2\]](#)

### Definition of Demand Feature

The proposal would amend the definition of demand feature in Rule 2a-7 to mean a feature permitting the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the time of exercise, paid within 397 calendar days of exercise. The proposed amendment would eliminate the requirement that a demand feature be exercisable at any time on no more than 30 calendar days' notice, a provision the SEC explains has become obsolete since the addition of the liquidity requirements in 2010. The proposal also is consistent with a position SEC staff has taken in the past. [\[3\]](#)

### Short-Term Floating Rate Securities

The proposal would clarify the method of determining WAL for short-term floating rate securities with demand features. Under the proposal, Rule 2a-7 would be amended to provide that, for purposes of determining WAL, a short-term floating rate security would be deemed to have a maturity equal to the period remaining until the principal amount can be recovered through demand. Consistent with previous informal staff guidance, [\[4\]](#) the release notes that most money market funds currently determine maturity for short-term floating rate securities consistent with the proposed amendment.

### Second Tier Securities

In 2010, the SEC amended Rule 2a-7 to limit money market funds to acquiring second tier securities with remaining maturities of 45 days or less. The proposal would amend Rule 2a-7 to state specifically that the 45-day limit must be determined without reference to the maturity-shortening provisions in Rule 2a-7 for interest rate readjustments. According to the Release, the SEC understands that most money market funds currently determine the remaining maturity for second tier securities consistent with the proposed amendment.

## **Proposed Compliance Dates**

With respect to any proposed amendments requiring certain historical disclosures, the SEC proposes that funds would be required only to disclose events that occur following the respective compliance date. The proposed compliance date is 2 years for the floating NAV alternative, 1 year for the liquidity fees and gates alternative, and 9 months for the other

proposed amendments that are not specifically related to the implementation of either alternative.

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**endnotes**

[1] See Money Market Fund Reform; Amendments to Form PF, SEC Release No. IC-30551 (June 5, 2013), available at <http://www.sec.gov/rules/proposed/2013/33-9408.pdf>.

[2] See Staff Responses to Questions About Money Market Fund Reform, (revised Nov. 24, 2010), available at <http://www.sec.gov/divisions/investment/guidance/mmfreform-imqa.htm>, Questions II.1, II.2, II.4.

[3] See, e.g., SEC No-Action Letter to Citigroup Global Markets, Inc. (May 28, 2009), available at <http://www.sec.gov/divisions/investment/noaction/2009/citigroupglobal052809-2a7.htm>.

[4] See Investment Company Institute, Request for Interpretation under Rule 2a-7 (Aug. 10, 2010) (incoming letter and response), available at <http://www.sec.gov/divisions/investment/noaction/2010/ici081010.htm>.

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