

SEC Proposes Amendments to Rules for Money Market Funds

The Securities and Exchange Commission (SEC) unanimously voted June 24, 2009, to propose significant rule amendments to enhance the current regulatory framework for money market funds. The amendments were proposed to increase the resiliency of money market funds to market stresses and to reduce the risks of runs on the funds (such as when the Reserve Primary Fund “broke the buck” last year). The SEC is also seeking comment on a number of questions regarding more fundamental changes to the regulation of money market funds, including whether a floating net asset value (NAV) might better protect investors and funds than the current stable NAV framework, as well as the role of credit rating agencies. Many of these proposals were offered as recommendations in the “Report of the Money Market Working Group” published by the Investment Company Institute, and more recently by the Obama Administration in its White Paper on Financial Regulatory Reform.

The SEC’s proposed amendments would:

- > enhance the risk-limiting requirements of Rule 2a-7 by tightening existing requirements or adding new requirements regarding maturity, quality and liquidity of the portfolio;
- > require additional disclosure of portfolio holdings of money market funds to investors and the SEC;
- > add stress-testing and “know your investors” requirements; and
- > facilitate an orderly liquidation if a money market fund breaks the buck.

Enhancements to Rule 2a-7’s risk-limiting requirements. The proposed amendments would add minimum liquidity standards by prohibiting money market funds from acquiring illiquid investments and imposing daily and weekly liquidity requirements. The details regarding these requirements have not yet been clarified. The proposals would enhance quality standards by requiring funds to acquire only the highest rated securities. Funds would be prohibited from acquiring second tier (lower rated) securities. The proposed amendments would address the effects of interest rate risk by shortening maturity standards. In particular, the SEC proposed to shorten a fund’s maximum weighted average maturity from 90 days to 60 days, as well as to institute a maximum weighted average life of a fund’s portfolio of 120 days. At the open meeting, the SEC staff clarified that they anticipated that funds’ existing securities holdings would mature and would not

need to be sold in order to satisfy these proposed requirements, because of transition periods after the proposed amendments are adopted.

Additional disclosure requirements. The SEC has proposed that funds be required to disclose their portfolio holdings on a monthly basis on their website, within two business days of the month's end, as well as file more detailed disclosures with the SEC on a monthly basis. This proposed requirement would help provide investors with more current information about the portfolio securities of funds they own or are considering for investment. Similarly, it would help the SEC to monitor funds.

Stress testing and "know your investors." Another aspect of the proposals would require that funds undergo ongoing stress testing to determine whether they can maintain a \$1 net asset value under a variety of scenarios, such as, for example, market disruptions, interest rate changes or a high number of redemptions. This proposal would require funds to determine which investors would be more likely to pose redemption risks.

Facilitation of orderly liquidation. The proposed amendments would require that all fund operations be able to process quickly purchases and redemptions in amounts other than \$1 in the event that a fund broke the buck. The proposals also would permit the boards of directors of money market funds to suspend redemptions from the fund if the fund breaks the buck, allowing for a more orderly liquidation of fund assets.

Request for comments. The SEC is requesting comment on the above proposals as well as on some more fundamental changes that it is not currently proposing, including:

- > whether to require money market funds to have the ability to do in-kind redemptions;
- > whether to substitute a floating NAV for the current stable NAV;
- > alternatives to the role of credit rating agencies in money market fund regulation, including the role of boards of directors; and
- > whether the "shadow pricing" NAV should be publicly disclosed.

The SEC may propose additional amendments after it considers the comments received.

Many of the proposed rule changes and additional requests for comment were included in recommendations by the Obama Administration in the White Paper on Financial Regulatory Reform that it released last week. The Paper included general recommendations about the potential use of a floating NAV, as well as requirements that the funds maintain liquidity buffers, reduce the maximum weighted maturity of fund assets, improve fund management and allow boards to suspend redemptions in circumstances where it is needed to protect fund shareholders' interests.

Please note that this information is based on the June 24, 2009, SEC Open Meeting, and that the proposed rule with additional details has not been released yet. We intend to follow up with a more in-depth analysis of the amendments when the release becomes available.

Investment Management Group

For more information about the matters discussed in this Alert, please contact your regular Drinker Biddle lawyer or any member of our Investment Management Group.

Partners and Counsel

Gary D. Ammon
(215) 988-2981
Gary.Ammon@dbr.com

Jeffrey Blumberg
(312) 569-1106
Jeff.Blumberg@dbr.com

Stephen T. Burdumy
(215) 988-2880
Stephen.Burdumy@dbr.com

Joshua B. Deringer
(215) 988-2959
Joshua.Deringer@dbr.com

Glenn E. Ferencz
(312) 569-1246
Glenn.Ferencz@dbr.com

Stephen D.D. Hamilton
(215) 988-1990
Stephen.Hamilton@dbr.com

Veena K. Jain
(312) 569-1167
Veena.Jain@dbr.com

Morgan R. Jones
(215) 988-2792
Morgan.Jones@dbr.com

Michelle M. Lombardo
(215) 988-2867
Michelle.Lombardo@dbr.com

Michael P. Malloy
(215) 988-2978
Michael.Malloy@dbr.com

David M. Matteson
(312) 569-1145
David.Matteson@dbr.com

Diana E. McCarthy
(215) 988-1146
Diana.McCarthy@dbr.com

Nancy P. O'Hara
(215) 988-2699
Nancy.OHara@dbr.com

Mary Jo Reilly
(215) 988-1137
MaryJo.Reilly@dbr.com

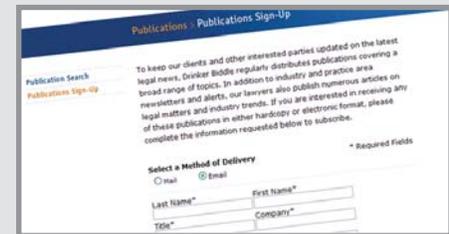
Audrey C. Talley
(215) 988-2719
Audrey.Talley@dbr.com

Other Publications



www.drinkerbiddle.com/publications

Sign Up



www.drinkerbiddle.com/publications/signup