

SEC ADOPTS MONEY MARKET FUND REFORM RULES

On February 23, 2010, the Securities and Exchange Commission adopted amendments to Rules 2a-7 and 17a-9 under the Investment Company Act of 1940, which govern money market funds.¹ The SEC also adopted other new rules and Form N-MFP. The rules and forms are designed to prevent future disruptions such as the crisis that struck money market funds in the fall of 2008. The amendments will, among other things:

- tighten the risk-limiting conditions of Rule 2a-7 by, among other things, requiring money market funds to maintain a portion of their portfolios in instruments that can be readily converted to cash, reducing the maximum weighted average maturity of portfolio holdings, imposing a maximum weighted average life of portfolio holdings, and improving the quality of portfolio securities;
- require money market funds to report their portfolio holdings to the SEC on a monthly basis and to disclose certain information on their websites each month;
- permit a money market fund that has “broken the buck” (*i.e.*, re-priced its shares below \$1.00 per share), or is at imminent risk of breaking the buck, to suspend redemptions to allow for the orderly liquidation of fund assets;
- limit the type of collateral for repurchase agreements that will be eligible for “look through” diversification treatment; and
- amend Rule 17a-9 under the Investment Company Act to expand the circumstances under which certain affiliated persons can purchase portfolio securities from a money market fund.

The amendments place new oversight responsibilities on fund boards and compliance obligations on fund advisers. As noted below, the SEC has indicated that more fundamental reforms relating to money market funds may follow at a later date.

¹ *Money Market Fund Reform*, Investment Company Act Release No. 29,132 (February 23, 2010) (“Adopting Release”), available at <http://www.sec.gov/rules/final/2010/ic-29132.pdf>. The rule amendments were proposed in June of 2009. See *Money Market Fund Reform*, Investment Company Act Release No. 28,807 (June 30, 2009) (“Proposing Release”), available at <http://www.sec.gov/rules/proposed/2009/ic-28807.pdf>.

Proposed New Rules and Rule Amendments Under the Investment Company Act

A. Portfolio Quality

The SEC amended Rule 2a-7 to further limit money market funds' investments in "second tier securities."² The amendments reduce permissible money market fund investments in second tier securities by:

- reducing the permitted percentage of a money market fund's "total assets" that may be invested in second tier securities to 3% from 5%;
- reducing the permitted concentration of a money market fund's total assets in second tier securities of a single issuer to 0.5% from the greater of 1% or \$1 million;³ and
- prohibiting money market funds from acquiring any second tier security with a remaining maturity in excess of 45 days.⁴

Rule 2a-7 also was amended to require that the board of each money market fund:

- designate four or more Nationally Recognized Statistical Rating Organizations ("NRSROs"), any one or more of whose short-term credit ratings the fund would look to under the rule in determining whether a security is an eligible security;⁵ and

² Second tier securities are eligible securities that, if rated, have received other than the highest short-term debt rating from the requisite Nationally Recognized Statistical Rating Organizations or, if unrated, have been determined by the fund's board to be of comparable quality. *See Amended Rule 2a-7(a)(24)* (defining "second tier security"); *Amended Rule 2a-7(a)(23)* (defining "requisite NRSROs").

³ In addition to the reduction in the ability of money market funds to acquire second tier securities of any particular issuer, the amended rules proportionately reduce by half the authority of a money market fund to acquire "demand features" or "guarantees" of a single issuer that are second tier securities to 2.5% from 5% of the money market fund's total assets. *See Amended Rule 2a-7(c)(4)(iii)(B)*.

⁴ *See Amended Rule 2a-7(c)(3); (c)(4)(i)(C).* The new second tier security restrictions apply to all money market funds, including tax-exempt funds. Prior to the rule amendments, taxable money market funds were subject to more stringent requirements than tax-exempt money market funds with regard to investments in second tier securities.

⁵ The SEC stated in the Adopting Release that "[b]efore designating an NRSRO and before making its annual determination, a board should have the benefit of the adviser's evaluation regarding the quality of the NRSRO's short-term ratings. [The SEC] would anticipate that the board's designations and annual determinations would be based on recommendations of the fund adviser and its credit analysts, who would have evaluated each NRSRO based on their experiences in addition to any information provided by the NRSRO. . . . Even with the recommendations of the fund adviser, [the SEC] recognize[s] that ultimately, a board's determination whether an NRSRO's ratings are 'sufficiently reliable' for use in determining whether a security is an eligible security will be a matter of judgment." *See Adopting Release at 32-33.* A designated NRSRO may not be an affiliated person of the issuer of, or any insurer or provider of credit support for, the security. *See Amended Rule 2a-7(a)(11)(ii).*

- determine at least once each calendar year that the designated NRSROs issue credit ratings that are sufficiently reliable for that purpose.⁶

A money market fund must identify its designated NRSROs in its statement of additional information (“SAI”).⁷ Once a money market fund’s board has designated the NRSROs, the fund can look to the designated NRSROs whenever it has to consider credit ratings under Rule 2a-7.⁸ After a money market fund acquires a security, the fund’s manager must monitor only the ratings of designated NRSROs to determine whether a change in those ratings requires the board to reassess promptly whether the security continues to present minimal credit risks or to dispose of a portfolio security that is no longer an eligible security.⁹ Before investing in an unrated security, a money market fund’s adviser (as the board’s delegate) must make a determination that the security is of comparable quality to a rated security.¹⁰

Finally, Rule 2a-7 was amended to eliminate a requirement that an asset backed security (“ABS”) be rated by at least one NRSRO in order to be an eligible security that a money market fund may acquire, consequently permitting a money market fund to acquire an unrated ABS that otherwise meets the requirements of Rule 2a-7.¹¹

⁶ See Amended Rule 2a-7(a)(11)(i). A fund may designate only credit rating agencies that are registered as NRSROs with the SEC under the Securities Exchange Act of 1934 (“Exchange Act”). See Exchange Act Section 15E. Under the amendments, a money market fund could designate an NRSRO with respect to short-term credit ratings for only certain types of issuers or securities. See Amended Rule 2a-7(a)(11)(i)(A); Adopting Release at 31.

⁷ See Amended Rule 2a-7(a)(11)(iii) (requiring a money market fund to disclose in its SAI its designated NRSROs and any limitations with respect to the fund’s use of such designation). Funds must also identify designated NRSROs in new Form N-MFP with respect to each of the fund’s portfolio securities.

⁸ The term “NRSRO” has been changed to “designated NRSRO” throughout Rule 2a-7. As a consequence, changes in a money market fund’s designated NRSROs may affect the ability of the fund to purchase a new security or rollover a current holding, and may require the fund to reassess promptly whether the security continues to present minimal creditworthiness and to dispose of a current holding. This is because a new designation of an NRSRO (or a removal of a designated NRSRO) is now treated under Rule 2a-7 as the equivalent of a credit event requiring the fund’s board or adviser to consider the rating of the newly designated NRSRO (or preclude the consideration of a formerly designated NRSRO). See Adopting Release at 34 & n.116.

⁹ See Amended Rule 2a-7(c)(7)(i)(A) (requiring a money market fund’s board to reassess promptly whether the security continues to present minimal credit risks and to cause the fund to take action if: (i) the security ceases to be a first tier security because it no longer has the highest rating from the requisite NRSROs or, in the case of an unrated security, the board determines it is no longer of comparable quality to a first tier security, or (ii) the security is an unrated security or second tier security and the fund’s investment adviser (or portfolio manager) becomes aware since the acquisition of the security that any designated NRSRO has given it a rating below the designated NRSRO’s second highest short-term rating); Amended Rule 2a-7(c)(7)(ii)(B) (requiring a fund to dispose of a security that ceases to be an eligible security as soon as practicable consistent with achieving an orderly disposition of the security, absent a finding by the board that disposal of the portfolio security would not be in the best interests of the money market fund).

¹⁰ See Amended Rule 2a-7(a)(12); (e).

¹¹ See Amended Rule 2a-7(a)(12)(ii); (c)(3)(iv)(C); (c)(7)(i)(A)(I).

B. Portfolio Maturity

The SEC amended Rule 2a-7 to reduce the exposure of money market fund investors to certain risks, including interest rate risk and spread risk, by further restricting maturity limitations of portfolio holdings. The amendments:

- reduce the maximum weighted average maturity (“WAM”) of a money market fund’s portfolio permitted by Rule 2a-7 to 60 days from 90 days;
- adopt a 120-day limit on the weighted average life (“WAL”) of a money market fund’s portfolio, which will limit the portion of a fund’s portfolio that may be held in longer-term adjustable-rate securities;¹² and
- delete a provision in Rule 2a-7 that permitted money market funds that relied exclusively on the penny-rounding method of pricing to acquire government securities with extended maturities of up to 762 calendar days.¹³

C. Portfolio Liquidity

The SEC amended Rule 2a-7 to require that money market funds maintain a sufficient degree of liquidity necessary to meet reasonably foreseeable redemption requests and reduce the likelihood that a fund will have to meet redemptions by selling portfolio securities into a declining market.

- General Liquidity Requirement. Rule 2a-7 was amended to require that each money market fund hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions in light of its obligations under Section 22(e) of the Investment Company Act and any commitments the fund has made to shareholders.¹⁴
 - The SEC expects money market fund managers to consider factors that could affect the fund’s liquidity needs, including the characteristics of a money market fund’s investors and their likely redemptions.¹⁵

¹² The 120-day limit applies to all securities in a money market fund’s portfolio, including government securities. See Adopting Release at 48.

¹³ Rule 2a-7 otherwise permits money market funds to acquire government securities with remaining maturities of up to 397 days. The SEC also amended the maturity-shortening provision of Rule 2a-7 for variable-rate government securities to require that the variable rate of interest be readjusted no less frequently than every 397 days, instead of 762 days. See Amended Rule 2a-7(d)(1).

¹⁴ See Amended Rule 2a-7(c)(5). Depending upon the volatility of its cash flows (particularly shareholder redemptions), this new provision may require a money market fund to maintain greater liquidity than would be required by the daily and weekly minimum liquidity requirements set forth in Rule 2a-7. Adopting Release at 51.

¹⁵ See Adopting Release at 52.

- To comply with the general liquidity requirement, money market funds should adopt policies and procedures designed to assure that appropriate efforts are undertaken to identify risk characteristics of shareholders.¹⁶ The SEC urges directors to consider the need for establishing guidelines that address the conflict between fund managers' interests in attracting additional fund assets and their overall duty to manage the fund in a manner consistent with maintaining a stable net asset value.¹⁷
- Limitation on Acquisition of Illiquid Securities. Under amended Rule 2a-7, a money market fund will not be permitted to acquire illiquid securities if, immediately after the acquisition, the fund would have invested more than 5% of its total assets in illiquid securities, *i.e.*, securities that cannot be sold or disposed of in the ordinary course of business within seven days at approximately the value ascribed to them by the money market fund.¹⁸
- Stress Testing. Rule 2a-7 also was amended to require a money market fund's board to adopt procedures providing for periodic stress testing of the fund's portfolio that will test the fund's ability to maintain a stable net asset value per share based upon certain hypothetical events.¹⁹ Money market funds must maintain records of these stress tests for six years, the first two years in an easily accessible place.²⁰

¹⁶ The SEC believes such policies and procedures are required under Rule 38a-1 under the Investment Company Act. *See* Adopting Release at 53 n.198. The SEC also noted that funds may seek access to information about investors who hold their interests through omnibus accounts in addition to considering information about the omnibus accounts, including their aggregate historical redemption patterns and the account recordholder's ability to redeem the entire account. The SEC noted that money market funds may seek access to this information in contractual arrangements with their financial intermediaries. *See* Adopting Release at 54 & n.201.

¹⁷ *See* Adopting Release at 53.

¹⁸ *See* Amended Rule 2a-7(c)(5)(i). Prior to the Rule 2a-7 amendments, a money market fund was permitted to invest up to 10% of its total assets in illiquid securities. Under Amended Rule 2a-7, a money market fund using the amortized cost method will be able to treat as liquid a security that the fund can sell at a price that deviates from the security's amortized cost value, as long as the price approximates the market-based value that the fund has ascribed to the security for purposes of determining its shadow price. The SEC believes that because the market-based value assigned by a money market fund to its securities is the measure that ultimately justifies the fund's use of a stable net asset value, a money market fund should treat as illiquid any security that cannot be sold at a price approximating such market-based value. *See* Adopting Release at 56 n.210; Amended Rule 2a-7(a)(19).

¹⁹ *See* Amended Rule 2a-7(c)(10)(v). These hypothetical events include an increase in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on portfolio securities, and a widening or narrowing of spreads between yields on an appropriate benchmark selected by the fund for overnight interest rates and commercial paper and other types of securities held by a money market fund. The testing is required to be done at such intervals as a fund's board determines to be appropriate and reasonable in light of current market conditions. The board is not, however, required to design the stress testing. The board must receive a report of the results of the stress testing at its next regularly scheduled meeting, and more frequently, if appropriate, in light of the results. The report must include: (i) the date(s) on which the fund's portfolio was tested and (ii) the magnitude of each hypothetical event that would cause the money market fund to break the buck. The report must also include an assessment by the fund's adviser of the fund's ability to withstand the events (and concurrent occurrences of those events) that are reasonably likely to occur within the following year.

²⁰ *See* Amended Rule 2a-7(c)(11)(vii).

- **Daily Liquid Assets.** The new daily liquidity standards require all *taxable* money market funds to hold at least 10% of their total assets in cash, direct obligations of the U.S. government, or securities that will mature or are subject to a demand feature that is exercisable and payable within one business day.²¹
- **Weekly Liquid Assets.** The new weekly liquidity standards require *all* money market funds, including tax-exempt money market funds, to hold at least 30% of their total assets in (i) cash, (ii) direct obligations of the U.S. government, (iii) government securities that are issued by a person controlled or supervised by and acting as an instrumentality of the U.S. government pursuant to authority granted by the U.S. Congress that (a) are issued at a discount to the principal amount to be repaid at maturity and (b) have a remaining maturity date of 60 days or less, or (iv) securities that will mature or are subject to a demand feature that is exercisable and payable within five business days.²²

A money market fund must comply with the daily and weekly liquidity standards at the time each portfolio security is acquired. A money market fund whose portfolio does not meet the minimum daily or weekly liquidity standards is not in violation of the rule, but may not acquire any assets other than daily or weekly liquid assets until the fund meets such standards.²³

D. Repurchase Agreements

The SEC adopted two amendments that affect money market fund investments in repurchase agreements for purposes of Rule 2a-7's diversification provisions,²⁴ including:

- limiting money market funds to investing in repurchase agreements collateralized by cash items or government securities in order to obtain special ("look through") treatment of those investments under the diversification provisions of Rule 2a-7;²⁵ and

²¹ See Amended Rule 2a-7(c)(5)(ii). See also Amended Rule 2a-7(a)(8) (defining "daily liquid assets").

²² See Amended Rule 2a-7(c)(5)(iii). See also Amended Rule 2a-7(a)(32) (defining "weekly liquid assets").

²³ See Adopting Release at 56 & n.212.

²⁴ For purposes of meeting Rule 2a-7's diversification provisions, money market funds may treat the acquisition of a repurchase agreement as an acquisition of the collateral underlying the repurchase agreement, provided that the repurchase agreement is "collateralized fully." In order to be "collateralized fully" a repurchase agreement may only be collateralized by the items enumerated in the definition of "collateralized fully" in Rule 2a-7. See Adopting Release at 70-71 & n.271.

²⁵ See Amended Rule 2a-7(a)(5) (defining the term "collateralized fully"); (c)(4)(ii)(A). Under the rule amendments, securities with the highest rating, or unrated securities of comparable credit quality, will no longer be acceptable collateral under the definition of the term "collateralized fully" in Rule 2a-7. This change is designed to reduce the risk that a money market fund would experience losses upon the sale of collateral in the event of a counterparty's default. See Adopting Release at 70 & n.271. A money market fund will still be permitted to invest in a repurchase agreement with other types of collateral, but the fund will not be permitted to "look through" to the collateral for diversification testing under Rule 2a-7. See Adopting Release at 70-71 n.273.

- reinstating the requirement that a money market fund's board or its delegate evaluate the creditworthiness of the repurchase agreement's counterparty in order for the fund to take advantage of the special ("look-through") treatment under Rule 2a-7's diversification provisions.²⁶

These rule amendments are designed to avoid losses caused by the default of a counterparty by limiting the types of collateral and requiring money market funds to evaluate the creditworthiness of the counterparty in order to limit exposure to less creditworthy institutions.²⁷

E. Disclosure of Portfolio Information

The amendments to Rule 2a-7 require certain portfolio information to be posted on a money market fund's website and certain additional portfolio information to be disclosed to the SEC. Current weekly reporting requirements for certain funds under Rule 30b1-6T will be extended and then phased out.

- Public Website Posting. Under amended Rule 2a-7, money market funds will be required to disclose certain information about their portfolio holdings each month on their websites. Money market funds must post the required portfolio information, current as of the last business day of the previous month, no later than the fifth business day of the month. Portfolio information must be maintained on a fund's website for no less than six months after posting.²⁸ Money market funds will be required to disclose the following on a monthly basis with respect to each security held:
 - the name of the issuer;
 - the category of investment (*e.g.*, Treasury debt, government agency debt, asset backed commercial paper, structured investment vehicle note);
 - the CUSIP number (if any);
 - the principal amount;
 - the maturity date as determined under Rule 2a-7 for purposes of calculating WAM;

²⁶ See Amended Rule 2a-7(c)(4)(ii)(A). The SEC previously eliminated this requirement in 2001. The purpose of this amendment is to require a money market fund adviser to determine that the counterparty is a creditworthy institution, separate and apart from the value of the collateral supporting the counterparty's obligation under the repurchase agreement. See Adopting Release at 71.

²⁷ See Adopting Release at 72.

²⁸ See Amended Rule 2a-7(c)(12).

- the final maturity date, if different from the maturity date previously described;
- coupon or yield; and
- the amortized cost value.

Funds also must disclose the overall WAM and WAL of their portfolios.²⁹

- Reporting to the SEC. New Rule 30b1-7 requires money market funds to file electronically certain portfolio information on new Form N-MFP with the SEC on a monthly basis.³⁰ Money market funds must report on Form N-MFP, with respect to each portfolio security held on the last business day of the prior month, the following items:
 - the name of the issuer;
 - the title of the issue, including the coupon or yield;
 - the CUSIP number;
 - the category of investment (*e.g.*, Treasury debt, government agency debt, asset backed commercial paper, structured investment vehicle note, repurchase agreement (including additional information regarding the underlying collateral of each repurchase agreement));
 - the NRSROs designated by the fund, the credit ratings given by each NRSRO, and whether each security is first tier, second tier, unrated, or no longer eligible;
 - the maturity date as determined under Rule 2a-7, taking into account the maturity shortening provisions of Rule 2a-7(d);
 - the final legal maturity date, taking into account any maturity date extensions that may be effected at the option of the issuer;
 - whether the instrument has certain enhancement features;

²⁹ The Proposing Release would have required money market funds to disclose on their websites the information required by Rules 12-12 through 12-14 of Regulation S-X. These requirements were deleted from the final amendments. *See Adopting Release at 73-76.*

³⁰ *See Rule 30b1-7.*

- the principal amount;
- the current amortized cost value;
- the percentage of the money market fund's assets invested in the security;
- whether the security is an illiquid security (as defined in amended Rule 2a-7(a)(19)); and
- explanatory notes.³¹

Money market funds must also disclose information about the fund's risk characteristics such as the dollar WAM of the fund's portfolio, its seven-day gross yield, the market-based values of each portfolio security and the fund's market-based net asset value per share, with separate entries for values that do and do not take into account any capital support agreements into which the fund may have entered.³² Under Rule 30b1-7, the information contained in the portfolio reports filed with the SEC on Form N-MFP will be available to the public 60 days after the end of the month to which the information pertains.³³ Each money market fund must submit Form N-MFP electronically to the SEC within five business days after the end of each month.³⁴

- Phase-out of Weekly Reporting by Certain Funds. The SEC adopted as final Rule 30b1-6T — a temporary rule that requires the weekly filing of portfolio information by money market funds in certain circumstances.³⁵ The only change to Rule 30b1-6T is the extension of its expiration date. Rule 30b1-6T will expire on December 1, 2010, which corresponds with the first filing of portfolio information required by new Rule 30b1-7.

³¹ See Adopting Release at 78-80; Rule 30b1-7.

³² See Adopting Release at 80-81; Item 18 (shadow net asset value of the series) and Item 25 (shadow net asset value of each class) on Form N-MFP.

³³ See Rule 30b1-7(b).

³⁴ See Rule 30b1-7. Form N-MFP must be filed electronically through the SEC's EDGAR system in an XML tagged data format. See Adopting Release at 88-89.

³⁵ Rule 30b1-6T requires any money market fund that has a market-based net asset value per share below \$0.9975 to provide the SEC with weekly fund-specific and security-specific information. The information required by Rule 30b1-6T is similar to the information money market funds participating in the Treasury Department's Guarantee Program were required to provide under similar circumstances. Prior to the adoption of Rule 30b1-7, Rule 30b1-6T was scheduled to expire on September 17, 2010. See Disclosure of Certain Money Market Fund Portfolio Holdings, Investment Company Act Release No. 28,903 (Sept. 18, 2009); Adopting Release at 89-90.

F. Processing of Transactions

The SEC amended Rule 2a-7 to require that a fund (or its transfer agent) have the capacity to redeem and sell its securities at a price based on the fund's current net asset value per share, including the capacity to sell and redeem shares at prices that do not correspond to the stable net asset value or price per share.³⁶ This amendment will require that shareholder transactions be processed in an orderly manner, even under circumstances that require a fund to "break the buck."

G. Exemption for Affiliate Purchases

In order to expand the circumstances under which certain affiliated persons can purchase portfolio securities from a money market fund, the SEC amended Rule 17a-9. The amendment permits money market funds to dispose of distressed securities quickly during times of market stress. Under the amendments to Rule 2a-7, all such transactions must be reported to the SEC.

- Expanded Exemptive Relief. The exemption from the Investment Company Act's prohibition on affiliated transactions provided to money market funds under Rule 17a-9 was expanded. Provided that the purchase price is paid in cash and is equal to the greater of the security's amortized cost or its market value (in each case, including accrued interest), an affiliated person of a money market fund is permitted to purchase from such money market fund:
 - a portfolio security that has ceased to be an eligible security, or has defaulted (other than an immaterial default unrelated to the financial condition of the issuer);³⁷ and
 - any other portfolio security, provided further that such person promptly remits to the fund any profit it realizes from the later sale of the security (a "clawback" provision).³⁸

³⁶ See Amended Rule 2a-7(c)(13). The focus of the rule is on the fund's ability to process transactions, rather than on the board's determination regarding that ability, because the issue is operational in nature and need not directly involve the board. See Adopting Release at 92.

³⁷ See Amended Rule 17a-9(a)(1)-(2).

³⁸ See Amended Rule 17a-9(b)(1)-(2); Adopting Release at 96.

- New Reporting Requirement. Rule 2a-7 was amended to require a money market fund whose securities have been purchased by an affiliated person in reliance on Rule 17a-9 to provide the SEC with prompt notice by electronic mail of the transaction and the reasons for the purchase.³⁹

H. Fund Liquidation

The SEC adopted new Rule 22e-3, which exempts money market funds from Section 22(e) of the Investment Company Act, to permit them to suspend redemptions and postpone payment of redemption proceeds in order to facilitate an orderly liquidation of the fund. The rule permits a money market fund to suspend redemptions and payment of redemption proceeds if:

- the fund's board, including a majority of disinterested directors, determines that the deviation between the fund's amortized cost price per share and its market-based net asset value per share may result in material dilution or other unfair results;
- the board, including a majority of disinterested directors, irrevocably has approved the liquidation of the fund; and
- the fund, prior to suspending redemptions, notifies the SEC of its decision to liquidate and suspend redemptions.⁴⁰

The rule is designed to facilitate the *permanent* termination of a money market fund in an orderly manner.

³⁹ See Amended Rule 2a-7(c)(7)(iii)(B). Under this provision, not only purchases by affiliated persons, but also purchases by promoters and principal underwriters of a fund and any affiliated person of such persons, which are exempt under Rule 17a-9, must be reported to the SEC. The notification must include the price at which the transaction was conducted and the amortized cost value of the security (which will be different if the market value is higher than the amortized cost).

⁴⁰ See Rule 22e-3(a). A suspension of redemptions under Rule 22e-3 is irrevocable. The SEC cautioned in the Adopting Release that a fund that intends to be able to rely on Rule 22e-3 may also need to update its prospectus to disclose the circumstances under which it may suspend redemptions. See Adopting Release at 98 n.378; Item 6 of Form N-1A. Under Rule 22e-3(b), a conduit fund (*i.e.*, a fund that invests in a money market fund in reliance on Section 12(d)(1)(E) of the Investment Company Act) may rely on the rule if the money market fund in which it invests has suspended redemptions under the rule. The SEC anticipates that this conduit provision will be used principally by insurance company separate accounts issuing variable insurance contracts and by funds participating in master-feeder arrangements. A conduit fund also must promptly notify the SEC that it has suspended redemptions in reliance on Rule 22e-3. See Adopting Release at 100 & n.387.

Compliance Dates

The amendments to Rules 2a-7, 17a-9 and 30b1-6T, new Rules 22e-3 and 30b1-7, and new Form N-MFP, become effective May 5, 2010.⁴¹ **The compliance date is May 5, 2010, except for certain amendments with the following subsequent compliance dates:**

Compliance Date	Amendments
May 28, 2010	Amendments to Rule 2a-7 related to portfolio quality, maturity, liquidity and repurchase agreements (except for the new maximum WAM and WAL limits and designation of NRSROs ⁴²).
June 30, 2010	New maximum WAM and WAL limits.
October 7, 2010	Public website disclosure.
December 7, 2010	Form N-MFP filings. (beginning on October 7, 2010 the SEC staff will be able to receive trial data from funds, on a voluntary basis, pursuant to the requirements of Rule 30b1-7)
December 31, 2010	Designated NRSROs must be disclosed in a money market fund's SAI.
October 31, 2011	Funds must be able to process transactions at prices other than stable net asset value.

⁴¹ If a money market fund has policies that can be changed only if authorized by a shareholder vote, such fund will not need to hold a shareholder vote merely to comply with the amendments, provided that the existing policy is less restrictive than the amendments in the release and does not conflict with those amendments. The SEC would also not object if a money market fund were to amend its registration statement to reflect the fund's compliance with the amended rule pursuant to Rule 485(b) under the Securities Act of 1933, if other changes in the fund's post-effective amendment meet the conditions for immediate effectiveness under Rule 485(b). *See* Adopting Release at 102.

⁴² Although the compliance date with respect to the amendments related to a money market fund's portfolio quality takes effect on May 28, 2010, the Adopting Release indicates that a fund must disclose its designated NRSROs in its SAI no later than December 31, 2010. The SEC stated that this additional time "should permit fund boards of directors to evaluate and designate NRSROs without the need to call a special board meeting. Fund boards are free to take advantage of the rule amendments any time after the effective date." *See* Adopting Release at 102. It would appear from this statement that the compliance date for a money market fund to designate its NRSROs also is December 31, 2010.

Action Items

In anticipation of the compliance dates set forth above, advisers to money market funds will need to address the following issues related to procedures and disclosure items:

- **Amend Rule 2a-7 Procedures.** A fund's Rule 2a-7 procedures should be amended to:
 - reflect the new limitations on second tier securities;
 - require designation of four or more NRSROs to be used to determine the eligibility of particular securities and to establish a requirement for an annual determination that NRSROs are sufficiently reliable for this use;
 - eliminate the requirement that ABS must receive at least one NRSRO rating;
 - reduce the maximum WAM from 90 days to 60 days;
 - adopt a 120-day limit on the WAL of the portfolio;
 - if the fund utilizes the penny-rounding method, delete permissible investments in government securities with extended maturities up to 762 calendar days — the maximum extended maturity of government securities for penny-rounding funds will be 397 days;
 - adopt new liquidity provisions (*i.e.*, general liquidity requirement, daily and weekly liquidity requirements and limitation on acquisition of illiquid securities);
 - adopt stress testing procedures and a requirement for reporting the results of such tests to the board;
 - reflect that repurchase agreements are eligible for “look through” treatment under the diversification provisions of Rule 2a-7 only if collateralized by cash items or government securities and if the board (or its delegate) evaluates the creditworthiness of the counterparty;
 - require the reporting of Rule 17a-9 transactions to the SEC; and
 - require the fund to have the ability to purchase and redeem shares at a price other than its stable net asset value.
- **Amendments to Rule 38a-1 Compliance Program.** A money market fund's Rule 38a-1 procedures should be amended (if necessary) to address the following:
 - adopt policies and procedures designed to assure that appropriate efforts are undertaken to identify risk characteristics of shareholders, so that money market funds can adopt appropriate general liquidity provisions;

- amend recordkeeping policies and procedures to maintain records of stress tests performed during the past six years, including keeping such records in an easily accessible place during the first two years of such period;
 - amend diversification testing policies for repurchase agreements so that money market funds are eligible for special diversification (“look through”) treatment under Rule 2a-7 only if a repurchase agreement is collateralized by cash items or government securities and if the board (or its delegate) evaluates the creditworthiness of the counterparty;
 - adopt policies and procedures with respect to the evaluation of the creditworthiness of repurchase agreement counterparties; and
 - adopt policies and procedures related to the website posting required by Rule 2a-7 and preparation and filing of Form N-MFP.
- **Form N-1A Disclosure Items.**
 - A money market fund’s Form N-1A should be amended to disclose the designated NRSROs.
 - A money market fund should consider adding disclosure related to the availability of Rule 22e-3 as a circumstance under which a fund may suspend redemptions.
 - **Public Website Disclosure.** A money market fund must establish a website with the required website disclosures and a link to the SEC webpage where a user may obtain access to the fund’s most recent 12 months of publicly available filings on Form N-MFP.
 - **Transaction Processing.** A money market fund must establish systems to process transactions at market-based net asset values per share rather than stable net asset values per share by October 31, 2011.

Potential Areas of Future Money Market Fund Reform

The SEC and its staff have indicated that additional rule proposals related to money market fund reform may be released on a future date. Such potential areas of future reform may include the following key items:

- **Variable Pricing.** The SEC may propose to prohibit use of the amortized cost method, thereby forcing money market fund net asset values and share prices to float based on market values of portfolio holdings. Even if the SEC decides not to prohibit the use of the amortized cost method, a future proposal may permit certain money market funds to continue to use the amortized cost method and to maintain a stable share price, while mandating that other money market funds have floating net asset values.

- **Public Disclosure of Shadow Net Asset Values.** In a subsequent release, the SEC may revisit whether to maintain, shorten or eliminate the lag in the public disclosure of information disclosed to the SEC on Form N-MFP.
- **Institutional vs. Retail.** The SEC intends to reexamine its prior proposal to require less stringent liquidity standards to money market funds for retail investors, as opposed to those with institutional investors. Because the SEC was unable to establish guidelines for distinguishing between money market funds based on the nature of their investors, the SEC adopted the more restrictive proposals that would have applied to institutional funds only.
- **Know Your Customer Procedures.** A question remains as to whether additional guidance will be provided requiring money market funds to implement robust “know your customer” procedures. Future rule amendments may remove the provision that exempts money market funds from Rule 22c-2 under the Investment Company Act.
- **Redemptions In-Kind.** The SEC may propose to require money market funds to redeem certain institutional investors’ redemption requests in-kind, in an attempt to allow for an orderly liquidation of a fund that has broken the buck.

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If you have any questions concerning the foregoing or would like additional information, please contact Benjamin J. Haskin (202-303-1124, bhaskin@willkie.com), Margery K. Neale (212-728-8297, mneale@willkie.com), or the Willkie attorney with whom you regularly work.

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