



## Money Market Funds Impacted by New ICI Recommendations

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*March 24, 2009* - The Investment Company Institute last week published the much-anticipated Report of its Money Market Working Group, concerning changes that can be made to make money market funds more resilient in extreme financial market conditions.

### *Recommended New Requirements*

The Report recommends that a money market fund be subject to many significant new requirements, including:

- To hold at least 5% of the fund's net assets in investments that, by their terms, provide the fund with access to its cash within one day and to hold at least 20% of its assets in investments that provide such access within one week.
- To at least weekly "stress test" the adequacy of the fund's liquidity position, based on hypothesized levels of credit risk, shareholder redemptions, and interest rate changes.
- To limit the weighted average maturity of the fund's portfolio to 75 days (as compared to the current 90-day limit) and to impose certain additional limits in connection with the maturity of variable rate portfolio obligations.
- To have the fund's investment adviser establish a "new products" or similar committee to review, approve and monitor novel securities, credit structures, or investment techniques that the fund may use.
- To designate at least three NRSROs that the fund will monitor for downgrades of the fund's portfolio securities.
- To develop procedures so that the fund will understand the expected redemption practices and liquidity needs of new investors admitted to the fund (or, in the absence of such information, to mitigate the possible adverse effects of any resulting unpredictability of redemption patterns).
- To post monthly website disclosures of client concentration levels by type of client and the risks that

such concentration, if any, may pose to the fund.

- To post monthly website disclosure of the fund's portfolio holdings (after a two-day lag).
- To invest only in "first tier" securities, rather than being permitted (as currently) to invest up to 5% of the fund's assets in less creditworthy "second tier" securities.

The Report recommends that the SEC amend its rules to mandate each of the foregoing changes. Even without regulatory action, however, we believe that many money market funds will voluntarily begin to adhere to these recommended changes over the next few months.

### *Recommended Best Practices*

The Report also recommends that money market funds adopt certain other best practices as to which the Report does not make any recommendation for SEC rulemaking. Thus, the Report recommends that a money market fund:

- Follow certain various enumerated best practices when determining that an investment by the fund presents "minimal credit risks."
- Adopt maximum target share ownership percentage levels for individual fund shareholders, types of shareholders or both, in order to reduce the risk to the fund from heavy redemptions from particular clients or types of clients.
- Review and revise the fund's disclosure materials to be sure that they fully capture the risks of investing in the fund. The Report provides a list of certain such risks that may be applicable to many money market funds.

Again, we believe that many money market funds will begin to adhere to these best practice recommendations.

### *Other Recommended SEC Actions*

The Report also recommends that the SEC take the following additional actions:

- Amend SEC rules so that a money market fund's board could suspend redemptions and purchases by the fund for up to five days if the fund's NAV has broken (or is reasonably believed to be about to break) a dollar.
- Adopt a rule that permits a money market fund's board to suspend redemptions in connection with adopting a plan of liquidation. (This would be similar in concept to a temporary rule that the SEC has adopted in connection with the Treasury Department's Temporary Guarantee Program for Money Market Funds.)
- Adopt a rule under the Investment Advisers Act to reduce investor and market confusion about funds that appear to be similar to money market funds, but that are not regulated as such.
- Amend SEC rules to expand in certain respects the circumstances under which an affiliate of a money market fund could, without SEC approval, purchase securities from the fund in an effort to protect the fund from losses.

- Delegate to the SEC staff the authority to reinstate an October 10, 2008 no-action letter to the ICI that permitted money market funds to use amortized cost for "shadow pricing" certain securities under specified market conditions. (This no-action letter expired early in 2009.)
- Revise Rule 2a-7 to more appropriately reflect the oversight role that money market fund boards should have.

### *No Proposed Fundamental Changes to Money Market Funds*

Although the Report recommends numerous significant changes in the regulation and operation of money market funds, none of the recommendations would fundamentally alter the nature of such funds. Thus, the report rejected suggestions by some that money market funds no longer be permitted to maintain a constant NAV, be required to maintain any form of "deposit" insurance for the benefit of their shareholders, or be regulated as special purpose banks. The report also recommended that Rule 2a-7's use of NRSRO ratings generally be preserved, subject to the other improvements in regulation and procedures that the Report recommends.

Nevertheless, the Report does recognize that any breakdown in the orderly operation of the markets of money market instruments can present certain "systemic" financial risks. In this regard, the Report recommends that money market funds and other institutional investors (on a non-public basis) provide relevant data to any governmental body that is charged with overseeing the markets as a whole. Also, the Report recommends that the SEC formalize a program to monitor any money market funds that have clearly been outperforming their peers. This monitoring would facilitate consideration of whether such over-performance was accompanied by increased risks that might have regulatory significance. In addition to such monitoring based on investment performance, the Report also recommends that the SEC staff monitor ten money market funds selected randomly each month.

Finally, the Report recommends that Treasury extend its Temporary Guarantee Program for Money Market Funds until it expires by its terms on September 18, 2009.

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The full Report may be found at [http://www.ici.org/pdf/ppr\\_09\\_mmwg.pdf](http://www.ici.org/pdf/ppr_09_mmwg.pdf).

We are continuing to consider these and other matters as they may affect funds, insurance companies, investment advisers, broker-dealers, NRSROs, and other market participants. Please contact any of our regulatory or litigation lawyers for more information.

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