



Money Market Funds Still "Under the Gun"

January 28, 2010 - The SEC yesterday adopted long-expected rule amendments intended to boost the resiliency of money market funds. The final text of the new rules is not yet available, but the SEC's press release summarizing the new rules is available [here](#).

Overview

Briefly, the new rules would impose requirements that a money market fund:

- maintain certain minimum percentages of its assets in highly liquid securities;
- invest no more than 5% (rather than 10% currently) of its assets in "illiquid" securities (as defined in the new rules);
- hold sufficient liquid securities to meet foreseeable redemptions and, in that connection, develop procedures for identifying (and anticipating redemption requests by) large investors whose redemptions may pose risks for the fund;
- observe certain tightened limits on investments in "second tier" (i.e., lower quality) securities;
- limit the weighted average maturity of the fund's portfolio to no more than 60 days (rather than 90 days currently);
- observe a maturity test that would limit the portion of a fund's portfolio that could be invested in longer-term floating rate securities;
- be subject to periodic "stress testing" of its ability to maintain a stable net asset value per share ("NAV") in the face of various hypothetical scenarios of adverse developments;
- annually designate at least four Nationally Recognized Statistical Rating Organizations ("NRSROs") whose ratings the fund's board deems reliable;
- comply with enhanced requirements in order to reduce certain risks in connection with investments by the fund in repurchase agreements;
- post its portfolio holdings on its web site monthly;
- report certain information monthly to the SEC, including "shadow" (mark-to-market) NAVs, which information would be available to the public 60 days later; and
- have the capability of electronically processing share purchase and redemption transactions at a price other than \$1.00 per share.

On the other hand, the new rules would ease current restrictions on money market funds by permitting a fund:

- to suspend redemptions of its shares without obtaining any order from the SEC, if the NAV "breaks the buck" and the fund's board decides to liquidate the fund;
- to have more flexibility to sell distressed assets to an affiliate without obtaining advance SEC approval; and
- to invest in certain asset-backed securities that have not been rated by an NRSRO.

Discussion

The new rules may presage a significantly different relationship between money market funds and the SEC, with the SEC performing a much more active ongoing role of reviewing detailed current information about a fund's portfolio securities and, in some cases, raising questions about the level of risk the fund is assuming. The new rules will provide the SEC with additional current information about money market fund investment portfolios that would facilitate much more active review and oversight by the agency.

Many provisions of the new rules are the same as or similar to measures that the SEC previously had proposed or discussed.¹ Many money market funds have already voluntarily been adhering to at least some of these types of requirements. Otherwise, however, the changes adopted yesterday by the SEC will tend to increase money market fund operating expenses and decrease returns to investors. The ever-expanding regulatory requirements will make it more and more difficult for smaller money market funds to remain economically viable. Accordingly, consolidation in the money market fund space can be expected to continue. Although most of the investment company industry seems generally supportive of the SEC's actions to date, some critics question whether the benefits to investors that will result from the new rules will outweigh the detriments.

Moreover, it seems that other shoes may yet drop. At yesterday's meeting, for example, SEC Chairman Mary Shapiro clearly indicated that she believes that more needs to be done, including changes that may more fundamentally alter the character of money market funds. For some time, the SEC has been working actively with the President's Working Group on Financial Markets on this subject. Shapiro listed a number of potential measures as being among those that the SEC and its staff are still considering, in conjunction with the President's Working Group, as well as independently:

- requiring redemptions to be paid "in kind," rather than cash, to certain large investors;
- requiring money market funds to participate in a private "liquidity facility" that would help assure that they would be able to meet all redemption requests without adversely affecting the interests of any investor;
- requiring all money market funds to use a "floating," rather than constant, NAV;
- requiring money market funds to use a floating NAV, except for funds that adhere to additional risk-limiting conditions and, perhaps, participate

- in a private liquidity facility; and
- requiring all money market funds to publicly disclosure shadow NAVs on a "real time" basis.

The idea that money market funds might be required to use a floating NAV has, not surprisingly, been greeted with especially strong opposition from most quarters in the industry (although some money market funds do use a floating NAV). Nevertheless, it is apparent that the SEC and the President's Working Group are continuing to give very serious consideration to that approach, among others.

The new rules adopted yesterday generally will be effective 60 days after their publication in the Federal Register. Nevertheless, funds will not be required to comply with some of the rules until later in the year.

For additional information:

Jorden Burt has formed a special Task Force to monitor these rules and other proposals relating to reform of financial services regulation. To obtain additional information about particular proposals that might have an impact on the insurance or reinsurance industries, you may contact Roland Goss (rcg@jordenusa.com or (202) 965-8148). To obtain additional information about particular proposals that might have an impact on the investment adviser and mutual fund industries, you may contact Tom Lauerman (tcl@jordenusa.com or (202) 965-8156). Or you may contact any of Jorden Burt's other regulatory attorneys.

[1] See, for example, our Task Force's discussion of such proposals in our August 4, 2009 Bulletin that is available [here](#).

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