

SEC Adopts New Money Market Fund Rules Revising Disclosure and Portfolio Quality Requirements

The Securities and Exchange Commission (the “SEC”) yesterday adopted new rules governing money market funds aimed to expand funds’ disclosures regarding their portfolios, improve the liquidity and credit quality of their assets, and generally limit the risk that any fund’s net asset value (“NAV”) may sink below \$1 per share. The SEC has not yet released the complete text of the new rules but is expected to do so shortly. The SEC will provide information on the effective date of the rules when they are published but has indicated that mandatory compliance with certain of the rules will be phased in over the course of 2010.

Disclosure of Mark-to-Market Net Asset Values

The new rules will require money market funds each month to post their portfolio holdings on their websites and to provide detailed monthly reports to the SEC, including disclosure of the fund’s mark-to-market net asset value (“shadow NAV”). The information reported to the SEC will be made available to the public with a 60-day delay. Currently, shadow NAVs are reported semi-annually with a 60-day delay.

Asset Liquidity Requirements

All money market funds will be required to hold at least 30% of their assets in cash, U.S. Treasuries, certain other government securities with remaining maturities of sixty days or less, or securities that convert into cash or mature within one week. Taxable funds will also be required to hold at least 10% of their assets in cash, U.S. Treasuries, or securities that convert into cash or mature within one day. All funds will be restricted to holding assets with a maximum “weighted average life” of 120 days (currently there is no limit -- the effect of this restriction is to limit investments in certain long-term adjustable-rate securities), and the existing maximum weighted average maturity requirement will be reduced from 90 days to 60 days. Funds will be prohibited from investing more than 5% of their portfolios in illiquid securities (the current limit is 10%). An “illiquid security” will be defined as any security that the fund cannot dispose of within 7 days at carrying value. Additionally, fund portfolios must be sufficiently liquid to meet “foreseeable” redemptions. To meet this latter requirement, funds will need to develop procedures to identify investors whose redemption requests may pose risks for the fund and anticipate the probability of significant redemption requests.

Additional Resources

For more information on Orrick's Financial Markets Group, visit our [web site](#).

Asset Credit Quality Requirements

The new rules will change the methods by which funds evaluate the credit quality of securities by requiring each fund to designate on a yearly basis at least four Nationally Recognized Statistical Rating Organizations (“NRSROs”) whose ratings the fund’s board considers reliable. The fund will be permitted to disregard ratings by other NRSROs. The current requirement that funds may purchase asset backed securities only if they are rated by an NRSRO will be eliminated. The proportion of assets that a fund may invest in “Second Tier” securities (generally, securities that are rated in the second highest short-term debt rating category by the requisite NRSROs) will be lowered from 5% to 3%, and funds will be prohibited from investing more than 0.5% of their assets in Second Tier securities issued by any single issuer rather than the current limit of the greater of 1% of assets and \$1 million. Also, funds will be prohibited from purchasing Second Tier securities maturing in more than 45 days (rather than the current limit of 397 days).

Suspensions of Redemptions and Certain Other Changes

The new rules will require each fund to examine its ability to maintain a stable NAV of \$1 per share in the event of severe market shocks (such as interest rate changes, higher redemptions, and/or changes in the credit quality of the portfolio) and, in order to facilitate the orderly liquidation of assets, will permit a fund to suspend redemptions if its NAV falls below \$1 per share and the fund’s board of directors decides to liquidate the fund. Funds must also be able to electronically process purchases and redemptions of their shares at prices other than \$1 per share. Under certain conditions, a fund will be able to purchase securities from an affiliated fund before rather than after ratings downgrades or defaults of such securities and without the need for prior approval from the SEC (although funds will still be required to notify the SEC of such transactions). The new rules will prohibit funds from "looking through" repurchase agreements and applying mandatory investment diversification criteria to the underlying collateral (rather than the repo seller) unless the collateral consists of cash items or government securities (in contrast, the current rules also permit funds to "look through" repurchase agreements when the collateral consists of non-government debt securities if certain conditions are met). Also, funds will be required to evaluate the creditworthiness of each repurchase counterparty regardless of the type of collateral being used.

In connection with adopting the new rules, the SEC has announced that it will continue to pursue more fundamental changes to the structure of money market funds, including, but not limited to, possibly requiring a floating NAV rather than the stable \$1 per share NAV currently in practice; establishing a two-tiered system of funds, with a stable NAV only for funds subject to stricter risk-limiting requirements or liquidity facility requirements; establishing a framework for a private liquidity facility to provide liquidity to funds in time of market stress; requiring real time disclosures of shadow NAVs; and requiring mandatory redemptions-in-kind for large redemptions, such as by institutional investors.

We encourage you to contact us if you have any questions regarding the new SEC rules or other recent government actions relating to the U.S. or international money markets.

CONTACT

Jim Croke

Partner, Financial Markets
jcroke@orrick.com
+1 (212) 506 5085

Peter Manbeck

Senior Counsel, Financial Markets
pmanbeck@orrick.com
+1 (212) 506 5095