Regulatory Alert

Regulatory Insights

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Money market fund reforms

The SEC proposal puts forth impactful changes to fund management and liquidity to improve the resilience and transparency of money market funds via amendments to rule 2a-7. These proposed amendments are wide-ranging, from changes in liquidity requirements and fees to pricing and reporting requirements and could have significant impacts on fund operations. Funds should evaluate their business models and reporting processes for potential impact and preparedness against these proposed changes.

The SEC, citing the susceptibility of money market funds to heavy redemptions and a lack of liquidity in times of stress, such as the COVID-19 pandemic and the 2008 financial crisis, is seeking to improve the resilience and transparency of money market funds by proposing amendments to certain rules under the Investment Company Act of 1940 that govern these funds, including rule 2a-7. Highlights of the SEC's proposed amendments follow.

Liquidity fees and redemption gates

Currently, rule 2a-7 allows money market funds to charge "fees and gates" on redemptions when the fund's weekly liquid assets fall below 30 percent of total assets. The fees and gates were intended to temper the effects of short-term investor panics but SEC states they have instead appeared to act as a bright line for prompting redemptions, thereby increasing the risk of investor runs. Therefore, the SEC is proposing to:

— Remove the tie between liquidity thresholds and "fee and gate" provisions.

— Remove the fee and gate provisions from rule 2a-7.

Portfolio liquidity requirements

Rule 2a-7 requires money market funds to hold at least 10 percent of their total assets in daily liquid assets and at least 30 percent in weekly liquid assets. These requirements are meant to ensure that funds can meet redemptions. Citing significant fund redemptions and outflows exceeding these thresholds during the COVID-19 pandemic, the SEC is proposing to increase the portfolio liquidity requirements to:

— At least 25 percent of total fund assets in daily liquid assets.

— At least 50 percent of total fund assets in weekly liquid assets.

Swing pricing requirements

Redemptions have associated trading costs and deplete a fund's daily or weekly liquid assets, which are currently borne by the remaining shareholders in the fund, which SEC states incentivizes the remaining shareholders to redeem as well. In an effort to shift the cost burden to the redeeming shareholders, the SEC is proposing to require institutional prime and tax-exempt money market funds to:

— Adopt swing pricing policies and procedures to adjust the fund's current net asset value (NAV) per share by a swing factor when the fund has net redemptions (across all share classes). The swing factor should reflect:

  – Current spreads.

  – Transactions costs associated with selling vertical slices of the fund's portfolio.

- Estimates of market impact costs.

Reporting requirements

The SEC also proposed amendments to revise the reporting requirements for money market funds in:

— Form N-CR: In addition to current filing requirements when portfolio securities default or insolvency events occur, funds would be required to:
  - File when the fund falls below a specified liquidity threshold.
  - Submit in structured data language.

— Form N-MFP (Monthly Schedule of Portfolio Holdings):
  - New information would be required for:
    - Shareholder concentrations: disclosure of names and percent ownership of all beneficial owners (not record owners) who hold > 5 percent of the relevant share class.
    - Composition of shareholders: disclosure of percentage of investors in various categories (e.g., pension plans, government entities, non-profits).
    - Liquidity management: New Part D covering disclosure of the amount of portfolio securities sold or disposed of during reporting period.
    - Swing pricing: Consistent with the proposed swing pricing requirement, disclosure of the number of times swing factors are applied during a reporting period.
    - Accuracy and consistency: wide-ranging changes to reporting requirements and practices that are intended to improve reported information, and enhance accuracy and consistency including reporting acquisitions in lots, more robust information on repurchase (repo) agreements, and categorization of "government" funds and cash management vehicles.
  - Additional revisions to Form N-MFP:
    - Would require funds to report the same daily information that is posted to their website (daily and weekly liquid assets, and NAV) in their monthly submission of Form N-MFP, as opposed to the current weekly information.

Weighted average maturity and weighted average life

The SEC, citing consistency, is also proposing to amend rule 2a-7 to specify standard calculations of "dollar-weighted average portfolio maturity" (WAM) and "dollar-weighted average life maturity" (WAL), which are key metrics in determining portfolio risk:

— Money market funds would be required to calculate WAM and WAL based on the percentage of each security's market value in the portfolio.

Negative interest rates

Finally, the SEC discusses the risk posed by negative interest rates and their potential impact on money market funds' ability to sustain stable share prices but concludes that rule 2a-7 currently provides sufficient flexibility for funds to navigate these risks by converting to floating NAV prices. Therefore, the SEC is not proposing changes to the pricing provisions of rule 2a-7 in relation to negative interest rates, but is proposing to:

— Expand government and retail money market funds' obligations to confirm they can fulfill shareholder transactions if they convert to floating NAV prices; including whether financial intermediaries have these capacities.

Comments on these proposed amendments are requested within 60 days of publication in the Federal Register.

See below for more information on the proposed amendments:

— *SEC Proposed Rule – Money Market Reforms*

— *SEC Fact Sheet – Money Market Reforms*

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