Yale University
EliScholar – A Digital Platform for Scholarly Publishing at Yale

YPFS Documents Browse by Media Type

7-8-2009

# Securities and Exchange Commission Money Market Fund Reform - Federal Register/Vol. 74, No. 129

United States: Securities and Exchange Commission (SEC)

Follow this and additional works at: https://elischolar.library.yale.edu/ypfs-documents

## Recommended Citation
United States: Securities and Exchange Commission (SEC), "Securities and Exchange Commission Money Market Fund Reform - Federal Register/Vol. 74, No. 129" (2009). *YPFS Documents*. 5185.
https://elischolar.library.yale.edu/ypfs-documents/5185

This Document is brought to you for free and open access by the Browse by Media Type at EliScholar – A Digital Platform for Scholarly Publishing at Yale. It has been accepted for inclusion in YPFS Documents by an authorized administrator of EliScholar – A Digital Platform for Scholarly Publishing at Yale. For more information, please contact elischolar@yale.edu.

Federal Register

**Wednesday,**
**July 8, 2009**

## Part II

# Securities and Exchange Commission

**17 CFR Parts 270 and 274**
**Money Market Fund Reform; Proposed Rule**

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 270 and 274

**[Release No. IC–28807; File No. S7–11–09]**

**RIN 3235–AK33**

## Money Market Fund Reform

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** The Securities and Exchange Commission (''Commission'' or ''SEC'') is proposing amendments to certain rules that govern money market funds under the Investment Company Act. The amendments would: Tighten the risk-limiting conditions of rule 2a–7 by, among other things, requiring funds to maintain a portion of their portfolios in instruments that can be readily converted to cash, reducing the weighted average maturity of portfolio holdings, and limiting funds to investing in the highest quality portfolio securities; require money market funds to report their portfolio holdings monthly to the Commission; and permit a money market fund that has ''broken the buck'' (*i.e.,* re-priced its securities below $1.00 per share) to suspend redemptions to allow for the orderly liquidation of fund assets. In addition, the Commission is seeking comment on other potential changes in our regulation of money market funds, including whether money market funds should, like other types of mutual funds, effect shareholder transactions at the market-based net asset value, *i.e.,* whether they should have ''floating'' rather than stabilized net asset values. The proposed amendments are designed to make money market funds more resilient to certain short-term market risks, and to provide greater protections for investors in a money market fund that is unable to maintain a stable net asset value per share.

**DATES:** Comments should be received on or before September 8, 2009.

**ADDRESSES:** Comments may be submitted by any of the following methods:

*Electronic Comments*

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an e-mail to *rule-comments@sec.gov.* Please include File Number S7–11–09 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

*Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–11–09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/proposed.shtml*). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Office of Regulatory Policy, at (202) 551–6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–8549.

**SUPPLEMENTARY INFORMATION:** The Commission is proposing for public comment amendments to rules 2a–7 [17 CFR 270.2a–7], 17a–9 [17 CFR 270.17a–9], and 30b1–5 [17 CFR 270.30b1–5], new rules 22e–3 [17 CFR 270.22e–3] and 30b1–6 [17 CFR 270.30b1–6], and new Form N–MFP under the Investment Company Act of 1940 (''Investment Company Act'' or ''Act'').[1]

### Table of Contents

I. Background
 A. Money Market Funds
 B. Market Significance
 C. Regulation of Money Market Funds
 D. Recent Developments
II. Discussion
 A. Portfolio Quality
 1. Second Tier Securities
 2. Eligible Securities
 3. Credit Reassessments
 4. Asset Backed Securities
 B. Portfolio Maturity
 1. Weighted Average Maturity
 2. Weighted Average Life
 3. Maturity Limit for Government Securities
 4. Maturity Limit for Other Portfolio Securities
 C. Portfolio Liquidity
 1. Limitation on Acquisition of Illiquid Securities
 2. Cash and Securities That Can Be Readily Converted to Cash
 3. Stress Testing
 D. Diversification
 E. Repurchase Agreements
 F. Disclosure of Portfolio Information
 1. Public Web site Posting
 2. Reporting to The Commission
 3. Amendment to Rule 30b1–5
 G. Processing of Transactions
 H. Exemption for Affiliate Purchases
 1. Expanded Exemptive Relief
 2. New Reporting Requirement
 I. Fund Liquidation
 1. Proposed Rule 22e–3
 2. Request for Comment on Other Regulatory Changes
III. Request for Comment
 A. Floating Net Asset Value
 B. In-Kind Redemptions
 IV. Paperwork Reduction Act Analysis
 V. Cost Benefit Analysis
 VI. Competition, Efficiency And Capital Formation
 VII. Regulatory Flexibility Act Certification
 VIII. Statutory Authority
Text of Proposed Rules and Form

## I. Background

### *A. Money Market Funds*

Money market funds are open-end management investment companies that are registered under the Investment Company Act and regulated under rule 2a–7 under the Act. They invest in high-quality, short-term debt instruments such as commercial paper, Treasury bills and repurchase agreements.[2] Money market funds pay dividends that reflect prevailing short-term interest rates and, unlike other investment companies, seek to maintain a stable net asset value per share, typically $1.00 per share.[3]

This combination of stability of principal and payment of short-term yields has made money market funds one of the most popular investment vehicles for many different types of investors. Commonly offered features, such as check-writing privileges, exchange privileges, and near-immediate liquidity, have contributed to the popularity of money market funds. More than 750 money market funds are registered with the Commission, and collectively they hold approximately

[1] 15 U.S.C. 80a. Unless otherwise noted, all references to statutory sections are to the Investment Company Act, and all references to rules under the Investment Company Act, including rule 2a–7, will be to Title 17, Part 270 of the Code of Federal Regulations [17 CFR part 270].

[2] Money market funds are also sometimes called ''money market mutual funds'' or ''money funds.''

[3] *See generally* Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), Investment Company Act Release No. 13380 (July 11, 1983) [48 FR 32555 (July 18, 1983)] (''1983 Adopting Release''). Most money market funds seek to maintain a stable net asset value per share of $1.00, but a few seek to maintain a stable net asset value per share of a different amount, *e.g.,* $10.00. For convenience, throughout this release, the discussion will simply refer to the stable net asset value of $1.00 per share.

$3.8 trillion of assets.[4] Money market funds account for approximately 39 percent of all investment company assets.[5]

Individual (or ''retail'') investors use money market funds for a variety of reasons. For example, they may invest in money market funds to hold cash temporarily or to take a temporary ''defensive position'' in anticipation of declining equity markets. Money market funds also play an important role in cash management accounts for banks, broker-dealers, variable insurance products, and retirement accounts. As of December 2008, about one-fifth of U.S. households' cash balances were held in money market funds.[6]

Different types of money market funds have been introduced to meet the differing needs of retail money market fund investors. Historically, most retail investors have invested in ''prime money market funds,'' which hold a variety of taxable short-term obligations issued by corporations and banks, as well as repurchase agreements and asset backed commercial paper secured by pools of assets.[7] Prime money market funds typically have paid higher yields than other types of money market funds available to retail investors.[8] ''Government money market funds'' principally hold obligations of the U.S. Government, including obligations of the U.S. Treasury and federal agencies and instrumentalities, as well as repurchase agreements collateralized by Government securities. Some government money market funds limit themselves to holding only Treasury obligations. Compared to prime funds, government funds generally offer greater safety of principal but historically have paid lower yields. ''Tax exempt money market funds'' primarily hold obligations of state and local governments and their instrumentalities, and pay interest that is generally exempt from federal income taxes.

Institutional investors account for a growing portion of investments in money market funds. These investors include corporations, bank trust departments, securities lending operations of brokerage firms, state and local governments, hedge funds and other private funds. Many corporate treasurers of large businesses have essentially ''outsourced'' cash management operations to money market funds, which may be able to manage cash more efficiently due both to the scale of their operations and their expertise. As of January 2008, approximately 80 percent of U.S. companies used money market funds to manage at least a portion of their cash balances.[9] At year-end 2008, U.S. non-financial businesses held approximately 32 percent of their cash balances in money market funds.[10] According to the Investment Company Institute, about 66 percent of money market fund assets are held in money market funds or share classes intended to be sold to institutional investors (''institutional money market funds'').[11]

Institutional money market funds hold securities similar to those held by prime funds and government funds. They typically have large minimum investment amounts (*e.g.,* $1 million), and offer lower expenses and higher yields due to the large account balances, large transaction values, and smaller number of accounts associated with these funds. As we will discuss in more detail below, institutional money market funds also tend to have greater investment inflows and outflows than retail money market funds.

*B. Market Significance*

Due in large part to the growth of institutional funds, money market funds have grown substantially over the last decade, from approximately $1.4 trillion in assets under management at the end of 1998 to approximately $3.8 trillion in assets under management at the end of 2008.[12] During this same period, retail taxable money market fund assets grew from approximately $835 billion to $1.36 trillion, or 63 percent, while institutional taxable money market fund assets grew from approximately $516 billion to $2.48 trillion, or 380 percent.[13]

One implication of the growth of money market funds is the increased role they play in the capital markets. They are by far the largest holders of commercial paper, owning almost 40 percent of the outstanding paper.[14] The growth of the commercial paper market has generally followed the growth of money market funds over the last three decades.[15] Today, money market funds provide a substantial portion of short-term credit extended to U.S. businesses.

Money market funds also play a large role in other parts of the short-term market. They hold approximately 23 percent of all repurchase agreements, 65 percent of state and local government short-term debt, 24 percent of short-term Treasury securities, and 44 percent of short-term agency securities.[16] They serve as a substantial source of financing in the broader capital markets, holding approximately 22 percent of all state and local government debt, approximately nine percent of U.S. Treasury securities and 15 percent of agency securities.[17]

As a consequence, the health of money market funds is important not only to their investors, but also to a

[4] *See* Investment Company Institute, *Trends in Mutual Fund Investing,* Apr. 2009, *available at http://www.ici.org/highlights/trends_04_09* (''ICI Trends'').

[5] *See id.*

[6] *See* Investment Company Institute, Report of the Money Market Working Group, at 21 (Mar. 17, 2009), *available at http://www.ici.org/pdf/ppr_09_mmwg.pdf* (''ICI Report'').

[7] *See* Investment Company Institute, 2009 Investment Company Fact Book, at 147, Table 38 (May 2009), *available at http://www.ici.org/pdf/2009_factbook.pdf* (''2009 Fact Book'').

[8] *See, e.g., iMoneyNet Money Fund Report* (Mar. 20, 2009), *available at http://www.imoneynet.com/files/Publication_News/mfr.pdf.*

[9] *See* ICI Report, *supra* note 6, at 28–29, Figure 3.7.

[10] *See id.* at 28–29, Figure 3.6.

[11] *See* Investment Company Institute, *Money Market Mutual Fund Assets,* June 11, 2009, *available at http://www.ici.org/highlights/mm_06_11_09.*

[12] *See* Investment Company Institute, 1999 Mutual Fund Fact Book, at 4 (May 1999), available at *http://www.ici.org/pdf/1999_factbook.pdf;* Investment Company Institute, *Trends in Mutual Fund Investing,* May 28, 2009, available at *http://www.ici.org/highlights/trends_04_2009.*

[13] *See* Investment Company Institute, 2008 Investment Company Fact Book, at 144, Table 35 (May 2008) (''2008 Fact Book''); 2009 Fact Book, *supra* note 7, at 147, Table 38.

[14] Federal Reserve Board, Statistical Release Z.1: Flow of Funds Accounts of the United States: Flows and Outstandings Fourth Quarter 2008, at 86, Table L.208 (Mar. 12, 2009), available at *http://www.federalreserve.gov/releases/z1/Current/z1.pdf* (''Fed. Flow of Funds Report'').

[15] *See* Instruments of the Money Market, at 121, Table 2 (Timothy Q. Cook & Robert K. Laroche eds., 1993), available at *http://www.richmondfed.org/publications/research/special_reports/instruments_of_the_money_market/pdf/full_publication.pdf;* Fed. Flow of Funds Report, *supra* note 14, at Tables L.206 and L.208. One commenter has called the growth of these two markets ''inextricably linked.'' *See* Leland Crabbe & Mitchell A. Post, *The Effect of SEC Amendments to Rule 2a–7 on the Commercial Paper Market,* at 4 (Federal Reserve Board, Finance and Economics Discussion Series #199, May 1992) (''Crabbe & Post'').

[16] These securities include securities issued or guaranteed by the Federal National Mortgage Association (''Fannie Mae''), the Federal Home Loan Mortgage Corporation (''Freddie Mac'') and the Federal Home Loan Banks. *See* ICI Report, *supra* note 6, at 19, Figure 2.3. *See generally* U.S. Treasury Department, FAQs on Fixed Income Agency Securities, available at *http://www.treas.gov/education/faq/markets/fixedfederal.shtml.*

[17] *See* Fed. Flow of Funds Report, *supra* note 14 (percentages derived from flow of funds data). Foreign banks also have relied substantially on U.S. money market funds for dollar-denominated funding. *See* Naohiko Baba, Robert N. McCauley, & Srichander Ramaswamy, *U.S. Dollar Money Market Funds and non-U.S. Banks,* BIS Quarterly Review, Mar. 2009, *available at http://www.bis.org/publ/qtrpdf/r_qt0903g.htm* (''U.S. Dollar Money Market Funds'').

large number of businesses and state and local governments that finance current operations through the issuance of short-term debt. A ''break in the link [between borrowers and money market funds] can lead to reduced business activity and pose risks to economic growth.'' [18] The regulation of money market funds, therefore, is important not only to fund investors, but to a wide variety of operating companies as well as state and local governments that rely on these funds to purchase their short-term securities.

### *C. Regulation of Money Market Funds*

The Commission regulates money market funds under the Investment Company Act and pursuant to rule 2a–7 under the Act. We adopted rule 2a–7 as an exemptive rule in 1983 and amended it in 1986 to facilitate the development of tax-exempt money market funds.[19] We also amended it substantially in 1991 (taxable funds) and 1996 (tax-exempt funds) to provide for a more robust set of regulatory conditions and to expand the rule to apply it to any investment company holding itself out as a money market fund.[20]

The Investment Company Act and applicable rules generally require that mutual funds price their securities at the current net asset value per share by valuing portfolio instruments at market value or, if market quotations are not readily available, at fair value determined in good faith by the board of directors.[21] As a consequence, the price at which funds will sell and redeem shares ordinarily fluctuates daily with changes in the value of the fund's portfolio securities. These valuation and pricing requirements are designed to prevent investors' interests from being diluted or otherwise adversely affected if fund shares are not priced fairly.[22]

Rule 2a–7, however, permits money market funds to use the amortized cost method of valuation and penny-rounding method of pricing instead, which facilitate money market funds' ability to maintain a stable net asset value.[23] Under the amortized cost method, portfolio securities generally are valued at cost plus any amortization of premium or accumulation of discount (''amortized cost'').[24] The basic premise underlying money market funds' use of the amortized cost method of valuation is that high-quality, short-term debt securities held until maturity will eventually return to the amortized cost value, regardless of any current disparity between the amortized cost value and market value, and would not ordinarily be expected to fluctuate significantly in value.[25] Therefore, the rule permits money market funds to value portfolio securities at their amortized cost so long as the deviation between the amortized cost and current market value remains minimal and results in the computation of a share price that represents fairly the current net asset value per share of the fund.[26]

To reduce the likelihood of a material deviation occurring between the amortized cost value of a portfolio and its market-based value, the rule contains several conditions (which we refer to as ''risk-limiting conditions'') that limit the fund's exposure to certain risks, such as credit, currency, and interest rate risks.[27] In addition, the rule includes certain procedural requirements overseen by the fund's board of directors. One of the most important is the requirement that the fund periodically ''shadow price'' the amortized cost net asset value of the fund's portfolio against the mark-to-market net asset value of the portfolio.[28] If there is a difference of more than ½ of 1 percent (or $0.005 per share), the fund's board of directors must consider promptly what action, if any, should be taken, including whether the fund should discontinue the use of the amortized cost method of valuation and re-price the securities of the fund below (or above) $1.00 per share, an event colloquially known as ''breaking the buck.'' [29]

### *D. Recent Developments*

Money market funds have had a record of stability during their more than 30 years of operation. Before last fall, only one money market fund had ever broken the buck.[30] This record appears to be due primarily to three factors. First, the short-term debt markets generally were relatively stable during this period. Second, many fund advisers (and their portfolio managers and credit analysts) were skillful in analyzing the risks of portfolio securities and thereby largely avoiding significant losses that could force a fund to break the buck.[31] Finally, fund managers and their affiliated persons have had significant sources of private capital that they were willing to make available to support the stable net asset

---

[18] *See* Mike Hammill & Andrew Flowers, *MMMF, and AMLF, and MMIFF,* Macroblog (Federal Reserve Bank of Atlanta), Oct. 30, 2008, available at *http://www.macroblog.typepad.com/macroblog/2008/10/index.html.*

[19] *See* 1983 Adopting Release, *supra* note 3; Acquisition and Valuation of Certain Portfolio Instruments by Registered Investment Companies, Investment Company Act Release No. 14983 (Mar. 12, 1986) [51 FR 9773 (Mar. 21, 1986)] (''1986 Adopting Release'').

[20] *See* Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 18005 (Feb. 20, 1991) [56 FR 8113 (Feb. 27, 1991)] (''1991 Adopting Release''); Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 21837 (Mar. 21, 1996) [61 FR 13956 (Mar. 28, 1996)] (''1996 Adopting Release'').

[21] *See* section 2(a)(41) of the Act (defining ''value'' of fund assets); rule 2a–4 (defining ''current net asset value'' for use in computing the current price of a redeemable security); and rule 22c–1 (generally requiring open-end funds to sell and redeem their shares at a price based on the funds' current net asset value as next computed after receipt of a redemption, purchase, or sale order).

[22] *See* Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 17589 at n.7 and accompanying text (July 17, 1990) [55 FR 30239 (July 25, 1990)] (''1990 Proposing Release'').

[23] The penny-rounding method of pricing means the method of computing a fund's price per share for purposes of distribution, redemption and repurchase whereby the current net asset value per share is rounded to the nearest one percent. *See* rule 2a–7(a)(18).

[24] *See* rule 2a–7(a)(2) (defining the amortized cost method as calculating an investment company's net asset value whereby portfolio securities are valued at the fund's acquisition cost as adjusted for amortization of premium or accretion of discount rather than at their value based on current market factors).

[25] *See* 1983 Adopting Release, *supra* note 3, at nn. 3–7 and accompanying text; Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies, Investment Company Act Release No. 12206, at nn. 3–4 and accompanying text (Feb. 1, 1982) [47 FR 5428 (Feb. 5, 1982)] (''1982 Proposing Release'').

[26] *See* rule 2a–7(c)(1), (c)(7)(ii)(C).

[27] For example, the rule requires, among other things, that a money market fund's portfolio securities meet certain credit quality requirements, such as being rated in the top one or two rating categories by nationally recognized statistical rating organizations (''NRSROs''), and by limiting the portion of the fund's portfolio that may be invested in securities rated in the second highest rating category. *See* rule 2a–7(c)(3). The rule also places limits on the remaining maturity of securities in the fund's portfolio. A fund generally may not acquire, for example, any securities with a remaining maturity greater than 397 days, and the dollar-weighted average maturity of the securities owned by the fund may not exceed 90 days. *See* rule 2a–7(c)(2).

[28] *See* rule 2a–7(c)(7); *see also supra* note 21 and accompanying text.

[29] *See* rule 2a–7(c)(7)(ii)(B). Regardless of the extent of the deviation, rule 2a–7 imposes on the board of a money market fund a duty to take appropriate action whenever the board believes the extent of any deviation may result in material dilution or other unfair results to investors or current shareholders. Rule 2a–7(c)(7)(ii)(C). *See* 1983 Adopting Release, *supra* note 3, at nn. 51–52 and accompanying text.

[30] In September 1994, a series of a small institutional money market fund re-priced its shares below $1.00 as a result of loss in value of certain floating rate securities. The fund promptly announced that it would liquidate and distribute its assets to its shareholders. *See* 1996 Adopting Release, *supra* note 20, at n.162.

[31] We made similar observations last year. *See* Temporary Exemption for Liquidation of Certain Money Market Funds, Investment Company Act Release No. 28487, at text accompanying nn. 6–7 (Nov. 20, 2008) [73 FR 71919 (Nov. 26, 2008)] (''Rule 22e–3T Adopting Release'').

value of a money market fund when it experienced losses in one or more of its portfolio securities.

Since the late 1980s, fund managers from time to time have sought to prevent a money market fund from breaking the buck by voluntarily purchasing distressed portfolio securities from the fund, directly or through an affiliated person, at the higher of market price or amortized cost.[32] These events occurred irregularly and involved a limited number of funds.[33] In response to these events, the Commission tightened the risk-limiting conditions of the rule for taxable funds in 1991 and for tax exempt funds in 1996.[34] Among other things, we added diversification requirements to the rule, which limited the exposure of a fund to any one issuer of securities, thus reducing the consequences of a credit event affecting the value of a portfolio holding.[35] We repeatedly emphasized the responsibility of fund managers to manage, and fund boards to oversee that the fund is managed, in a manner consistent with the investment objective of maintaining a stable net asset value.[36]

In 2007, however, losses in the subprime mortgage markets adversely affected a significant number of money market funds. These money market funds had invested in asset backed commercial paper issued by structured investment vehicles (''SIVs''), which were off-balance sheet conduits sponsored mostly by certain large banks and money managers.[37] Although we understand that most SIVs had little exposure to sub-prime mortgages, they suffered severe liquidity problems and significant losses when risk-averse short-term investors (including money market funds), fearing increased exposure to liquidity risk and residential mortgages, began to avoid the commercial paper the SIVs issued.[38] Unable to roll over their short-term debt, SIVs were forced to liquidate assets to pay off maturing obligations and began to wind down operations.[39] In addition, NRSROs rapidly downgraded SIV securities, increasing downward price pressures already generated by these securities' lack of liquidity. The value of the commercial paper fell, which threatened to force several money market funds to break the buck.

Money market funds weathered this storm. In some cases, bank sponsors of SIVs provided support for the SIVs.[40] In other cases, money market fund affiliates voluntarily provided support to the funds by purchasing the SIV investments at their amortized cost or providing some form of credit support.[41] Money market funds also benefited from strong cash flows into money market funds, as investors fled from riskier markets. During the period from July 2007 to August 2008, more than $800 billion in new cash was invested in money market funds, increasing aggregate fund assets by one-third.[42] Eighty percent of these investments came from institutional investors.[43]

As financial markets continued to deteriorate in 2008, however, money market funds came under renewed stress. This pressure culminated the week of September 15, 2008 when the bankruptcy of Lehman Brothers Holdings Inc. (''Lehman Brothers'') led to heavy redemptions from about a dozen money market funds that held Lehman Brothers debt securities. On September 15, 2008, The Reserve Fund, whose Primary Fund series held a $785 million position in commercial paper issued by Lehman Brothers, began experiencing a run on its Primary Fund, which spread to the other Reserve funds. The Reserve funds rapidly depleted their cash to satisfy redemptions, and began offering to sell the funds' portfolio securities into the market, further depressing their valuations. Unlike the other money market funds that held Lehman Brothers debt securities (and SIV commercial paper), The Reserve Primary Fund ultimately had no affiliate with sufficient resources to support the $1.00 net asset value. On September 16, 2008, The Reserve Fund announced that as of that afternoon, its Primary Fund would break the buck and price its securities at $0.97 per share.[44] On September 22, 2008, in response to a request by The Reserve Fund, the Commission issued an order permitting the suspension of redemptions in certain Reserve funds, to permit their orderly liquidation.[45]

These events led many investors, especially institutional investors, to redeem their holdings in other prime money market funds and move assets to Treasury or government money market funds.[46] This trend was intensified by turbulence in the market for financial sector securities as a result of the bankruptcy of Lehman Brothers and the near failure of American International Group, whose commercial paper was

[32] These transactions implicate section 17(a) of the Investment Company Act, which prohibits an affiliated person of a fund or an affiliated person of such a person from knowingly purchasing a security from the fund, except in limited circumstances. Under section 17(b) of the Act, such persons can apply to the Commission for an exemption from these prohibitions. In 1996, the Commission adopted rule 17a–9, which permits affiliated persons of funds and affiliated persons of such persons to purchase distressed securities in funds' portfolios subject to certain conditions, without the need to first obtain an individual exemption. We are proposing certain amendments to rule 17a–9 in this release, as well as an amendment to rule 2a–7 that would require money market funds to notify us of any transactions under rule 17a–9. *See infra* Section II.H.

[33] *See* 1990 Proposing Release, *supra* note 22, at nn.16–18 and accompanying text; 1996 Adopting Release, *supra* note 20, at nn. 22–23 and accompanying text.

[34] *See* 1991 Adopting Release, *supra* note 20; 1996 Adopting Release, *supra* note 20.

[35] *See* rule 2a–7(c)(4).

[36] *See* 1983 Adopting Release, *supra* note 3, at nn. 41–42 and accompanying text; 1996 Adopting Release, *supra* note 20, at nn. 22–29 and accompanying text.

[37] *See* Neil Shah, *Money Market Funds Cut Exposure to Risky SIV Debt—S&P,* Reuters, Nov. 21, 2007, *available at http://www.reuters.com/article/bondsNews/idUSN2146813220071121.*

[38] We know of at least 44 money market funds that were supported by affiliates because of SIV investments. In many of these cases the affiliate support was provided in reliance on no-action assurances provided by Commission staff. Many of these no-action letters are available on our Web site. *See http://www.sec.gov/divisions/investment/im-noaction.shtml#money.* Unlike other asset backed commercial paper, SIV debt was not backed by an external liquidity provider.

[39] *See, e.g.,* Alistair Barr, *HSBC's Bailout Puts Pressure on Citi, ''Superfund,''* MarketWatch, Nov. 26, 2007, available at *http://www.marketwatch.com/story/hsbcs-35-bln-siv-bailout-puts-pressure-on-citi-superfund.*

[40] *See, e.g., id.*

[41] *See, e.g.,* Shannon D. Harrington & Christopher Condon, *Bank of America, Legg Mason Prop Up Their Money Funds,* Bloomberg, Nov. 13, 2007, available at *http://www.bloomberg.com/apps/news?pid=20601087&sid=aWWjLp8m3J1I&refer=home.* Under rule 17a–9, funds are not required to report to us all such transactions. *See infra* Section II.H.

[42] *See* ICI Report, *supra* note 6, at 49.

[43] *Id.*

[44] *See* Press Release, The Reserve Fund, A Statement Regarding The Primary Fund (Sept. 16, 2008). The Reserve Fund subsequently stated that the fund had broken the buck earlier in the day on September 16. *See* Press Release, The Reserve Fund, Important Notice Regarding Reserve Primary Fund's Net Asset Value (Nov. 26, 2008) (''The Fund is announcing today that, contrary to previous statements to the public and to investors, the Fund's net asset value per share was $0.99 from 11 a.m. Eastern time to 4 p.m. Eastern time on September 16, 2008 and *not* $1.00.'').

[45] *See* In the Matter of The Reserve Fund, Investment Company Act Release No. 28386 (Sept. 22, 2008) [73 FR 55572 (Sept. 25, 2008)] (order). Several other Reserve funds also obtained an order from the Commission on October 24, 2008 permitting them to suspend redemptions to allow for their orderly liquidation. *See* Reserve Municipal Money-Market Trust, et al., Investment Company Act Release No. 28466 (Oct. 24, 2008) [73 FR 64993 (Oct. 31, 2008)] (order).

[46] *See* U.S. Dollar Money Market Funds, *supra* note 17, at 72; BlackRock, The Credit Crisis: U.S. Government Actions and Implications for Cash Investors (Nov. 2008), *available at https://www2.blackrock.com/webcore/litService/search/getDocument.seam?venue=PUB_INS&ServiceName=PublicServiceView&ContentID=50824* (''The Credit Crisis''); Standard & Poor's, *Money Market Funds Tackle 'Exuberant Irrationality,'* Ratings Direct, Sept. 30, 2008, *available at http://www2.standardandpoors.com/spf/pdf/media/MoneyMarketFunds_Irrationality.pdf.*

held by many prime money market funds.

During the week of September 15, 2008, investors withdrew approximately $300 billion from prime (taxable) money market funds, or 14 percent of the assets held in those funds.[47] Most of the heaviest redemptions were from institutional funds, which depleted cash positions and threatened to force a fire sale of portfolio securities that would have placed widespread pressure on fund share prices.[48] Fearing further redemptions, money market fund (and other cash) managers began to retain cash rather than invest in commercial paper, certificates of deposit or other short-term instruments.[49] In the final two weeks of September 2008, money market funds reduced their holdings of top-rated commercial paper by $200.3 billion, or 29 percent.[50]

As a consequence, short-term markets seized up, impairing access to credit in short-term private debt markets.[51] Some commercial paper issuers were only able to issue debt with overnight maturities.[52] The interest rate premium (spread) over three-month Treasury bills paid by issuers of three-month commercial paper widened significantly from approximately 25–100 basis points before the September 2008 market events to approximately 200–350 basis points, and issuers were exposed to the costs and risks of having to roll over increasingly large amounts of commercial paper each day.[53] Many money market fund sponsors took extraordinary steps to protect funds' net assets and preserve shareholder liquidity by purchasing large amounts of securities at the higher of market value or amortized cost and by providing capital support to the funds.[54]

On September 19, 2008, the U.S. Department of the Treasury and the Board of Governors of the Federal Reserve System (''Federal Reserve Board'') announced an unprecedented market intervention by the federal government in order to stabilize and provide liquidity to the short-term markets. The Department of the Treasury announced its Temporary Guarantee Program for Money Market Funds (''Guarantee Program''), which temporarily guaranteed certain investments in money market funds that decided to participate in the program.[55] The Federal Reserve Board announced the creation of its Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (''AMLF''), through which it extended credit to U.S. banks and bank holding companies to finance their purchases of high-quality asset backed commercial paper from money market funds.[56] In addition, the Federal Reserve Board's Commercial Paper Funding Facility (''CPFF'') provided support to issuers of commercial paper through a conduit that purchased commercial paper from eligible issuers, although the CPFF did not purchase commercial paper from money market funds.[57] The Commission and its staff worked closely with the Treasury Department and the Federal Reserve Board to help design these programs, most of which relied in part on rule 2a–7 to tailor the program and/or condition the terms of a fund's participation in the program, and we also assisted in administering the Guarantee Program.[58] Our staff also

[47] *See* ICI Report, *supra* note 6, at 62 (analyzing data from iMoneyNet); *see also* Investment Company Institute, *Money Market Mutual Fund Assets Historical Data,* Apr. 30, 2009, *available at http://www.ici.org/pdf/mm_data_2009.pdf* (''ICI Mutual Fund Historical Data'').

[48] *See* ICI Mutual Fund Historical Data, *supra* note 47.

[49] *See* Philip Swagel, ''The Financial Crisis: An Inside View,'' Brookings Papers on Economic Activity, at 31 (Spring 2009) (conference draft), available at *http://www.brookings.edu/economics/bpea/~/media/Files/Programs/ES/BPEA/2009_spring_bpea_papers/2009_spring_bpea_swagel.pdf.*

[50] *See* Christopher Condon & Bryan Keogh, *Funds' Flight from Commercial Paper Forced Fed Move,* Bloomberg, Oct. 7, 2008, *available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a5hvnKFCC_pQ.*

[51] *See Minutes of the Federal Open Market Committee,* Federal Reserve Board, Oct. 28–29, 2008, at 5, *available at http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20081029.pdf* (''*FRB Open Market Committee Oct. 28–29 Minutes*'') (stating that following The Reserve Fund's announcement that the Primary Fund would break the buck, ''risk spreads on commercial paper rose considerably and were very volatile'' and ''[c]onditions in short-term funding markets improved somewhat following the announcement of * * * a number of mutual initiatives by the Federal Reserve and the Treasury to address the pressures on money market funds and the commercial paper market''). *See also* Press Release, Federal Reserve Board Announces Creation of the Commercial Paper Funding Facility (CPFF) to Help Provide Liquidity to Term Funding Markets (Oct. 7, 2008), *available at http://www.federalreserve.gov/newsevents/press/monetary/20081007c.htm* (''The commercial paper market has been under considerable strain in recent weeks as money market mutual funds and other investors, themselves often facing liquidity pressures, have become increasingly reluctant to purchase commercial paper, especially at longer-dated maturities. As a result, the volume of outstanding commercial paper has shrunk, interest rates on longer term commercial paper have increased significantly, and an increasingly high percentage of outstanding paper must now be refinanced each day. A large share of outstanding commercial paper is issued or sponsored by financial intermediaries, and their difficulties placing commercial paper have made it more difficult for those intermediaries to play their vital role in meeting the credit needs of businesses and households.'').

[52] *See* Matthew Cowley, *Burnt Money Market Funds Stymie Short-Term Debt,* Dow Jones International News, Oct. 1, 2008; Anusha Shrivastava, *Commercial-Paper Market Seizes Up,* The Wall Street Journal, Sept. 19, 2008, at C2.

[53] *See* Federal Reserve Board data, *available at http://www.frbatlanta.org/econ_rd/macroblog/102808b.jpg* (charting three-month commercial paper spreads over three-month Treasury bill); *see also* Federal Reserve Board Chairman Ben S. Bernanke, Testimony before the Committee on Financial Services, U.S. House of Representatives (Nov. 18, 2008), *available at http://www.federalreserve.gov/newsevents/testimony/bernanke20081118a.htm.*

[54] Commission staff provided no-action assurances allowing 100 money market funds in 18 different fund complexes to enter into such arrangements during the period from September 16, 2008 to October 1, 2008. *See, e.g., http://www.sec.gov/divisions/investment/im-noaction.shtml#money.*

[55] *See* Press Release, U.S. Department of the Treasury, Treasury Announces Guaranty Program for Money Market Funds (Sept. 19, 2008), *available at http://www.treas.gov/press/releases/hp1147.htm.* The Program insures investments in money market funds, to the extent of their shareholdings as of September 19, 2008, if the fund has chosen to participate in the Program. The Guarantee Program is due to expire on September 18, 2009. We adopted, on an interim final basis, a temporary rule, rule 22e–3T, to facilitate the ability of money market funds to participate in the Guarantee Program. The rule permits a participating fund to suspend redemptions if it breaks a buck and liquidates under the terms of the Program. *See* Rule 22e–3T Adopting Release, *supra* note 31. The temporary rule will expire on October 18, 2009. We discuss this rule in more detail in *infra* Section II.I.

[56] *See* Press Release, Federal Reserve Board, Federal Reserve Board Announces Two Enhancements to Its Programs to Provide Liquidity to Markets (Sept. 19, 2008), *available at http://www.federalreserve.gov/newsevents/press/monetary/20080919a.htm.* The AMLF will expire on February 1, 2010, unless extended. *See* Press Release, Federal Reserve Board, Federal Reserve Announces Extensions of and Modifications to a Number of Its Liquidity Programs (June 25, 2009), *available at http://www.federalreserve.gov/newsevents/press/monetary/20090625a.htm* (''2009 Federal Reserve Extension and Modification Announcement'').

[57] *See* Press Release, Federal Reserve Board, Board Announces Creation of the Commercial Paper Funding Facility (CPFF) to Help Provide Liquidity to Term Funding Markets (Oct. 7, 2008), *available at http://www.federalreserve.gov/newsevents/press/monetary/20081007c.htm.* At one point the Federal Reserve had purchased about one-fifth of all commercial paper outstanding in the U.S. market. *See* Bryan Keogh, *GE Leads Commercial Paper ''Test'' as Fed's Buying Ebbs,* Bloomberg, Jan. 27, 2009, *available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aHWA87Aa2aQQ.* The CPFF will expire on February 1, 2010, unless extended. *See* 2009 Federal Reserve Extension and Modification Announcement, *supra* note 56. Although the CPFF did not directly benefit money market funds, it did indirectly benefit them by stabilizing the commercial paper market. *See, e.g.,* Richard G. Anderson, *The Success of the CPFF?* (Economic Synopses No. 18, Federal Reserve Bank of St. Louis, 2009), at 2, *available at http://www.research.stlouisfed.org/publications/es/09/ES0918.pdf.*

[58] *See, e.g.,* Guarantee Agreement that money market funds participating in the Treasury's Guarantee Program were required to sign, at 2, 10, *available at http://www.treas.gov/offices/domestic-finance/key-initiatives/money-market-docs/Guarantee-Agreement_form.pdf* (under which money market funds were required to state that they operated in compliance with rule 2a–7 to be eligible to initially participate in the program and must continue to comply with rule 2a–7 to continue to

worked with sponsors of money market funds to provide regulatory relief they requested to participate fully in these programs.[59]

These steps helped to stanch the tide of redemptions from institutional prime money market funds,[60] and provided liquidity to money market funds that held asset backed commercial paper. Commercial paper markets remained illiquid, however, and, as a result, money market funds experienced significant problems pricing portfolio securities. Institutional as well as retail money market funds with little redemption activity and no distressed securities reported to our staff that they nevertheless faced the prospect of breaking the buck as a consequence of their reliance on independent pricing services that reported prices based on models with few reliable inputs. The Commission's Office of Chief Accountant and the Financial Accounting Standards Board provided funds and others guidance on determining fair value of securities in turbulent markets,[61] but it appeared that fund boards remained reluctant to deviate from the prices received from their vendors. On October 10, 2008, our Division of Investment Management issued a letter agreeing not to recommend enforcement action if money market funds met the ''shadow pricing'' obligations of rule 2a–7 by pricing certain of their portfolio securities with a remaining final maturity of less than 60 days by reference to their amortized cost.[62]

Over the four weeks after The Reserve Fund's announcement, assets in institutional prime money market funds shrank by 30 percent, or approximately $418 billion (from $1.38 trillion to $962 billion).[63] No money market fund other than The Reserve Primary Fund broke the buck, although money market fund sponsors or their affiliated persons in many cases committed extraordinary amounts of capital to support the $1.00 net asset value per share. Our staff estimates that during the period from August 2007 to December 31, 2008, almost 20 percent of all money market funds received some support from their money managers or their affiliates.[64]

During this time period, short-term credit markets became virtually frozen as market participants hoarded cash and generally refused to lend on more than an overnight basis.[65] Interest rate spreads increased dramatically.[66] After shrinking to historically low levels as credit markets boomed in the mid-2000s, interest rate spreads surged upward in the summer of 2007 and peaked after the bankruptcy of Lehman Brothers in September 2008.[67] Money market funds shortened the weighted average maturity of their portfolios to be better positioned in light of increased liquidity risk to the funds.[68]

Although the crisis money markets faced last fall has abated, the problems have not disappeared. Today, while interest rate spreads have recently declined considerably, they remain above levels prior to the crisis,[69] and short-term debt markets remain fragile.[70] Although the average weighted average maturity of taxable money market funds (as a group) had risen to 53 days as of the week ended June 16, 2009,[71] we understand that the long-term securities that account for the longer weighted average maturity are not commercial paper and corporate medium term notes (as they were before the crisis), but instead are predominantly government securities, which suggests that money market funds may still be concerned about credit risk.

The Treasury Guarantee Program has been extended twice, but is set to expire on September 18, 2009.[72] Programs

participate in the program); *see also http://www.sec.gov/divisions/investment/mmtempguarantee.htm.*

[59] *See* Investment Company Institute, SEC Staff No-Action Letter (Sept. 25, 2008) (relating to the AMLF); Investment Company Institute, SEC Staff No-Action Letter (Oct. 8, 2008) (relating to the Guarantee Program). These no-action letters are available on our Web site at *http://www.sec.gov/divisions/investment/im-noaction.shtml#money.*

[60] During the week ending September 18, 2008, taxable institutional money market funds experienced net outflows of $165 billion. *See Money Fund Assets Fell to $3.4T in Latest Week,* Associated Press, Sept. 18, 2008. Almost $80 billion was withdrawn from prime money market funds even after the announcement of the Guarantee Program on September 19, 2008. *See* Diana B. Henriques, *As Cash Leaves Money Funds, Financial Firms Sign Up for U.S. Protection,* N.Y. Times, Oct. 2, 2008, at C10. However, by the end of the week following the announcement, net outflows from taxable institutional money market funds had ceased. *See Money Fund Assets Fell to $3.398T in Latest Week,* Associated Press, Sept. 25, 2008.

[61] *See* Press Release No. 2008–234, Securities and Exchange Commission, Office of the Chief Accountant and FASB Staff Clarifications on Fair Value Accounting (Sept. 30, 2008), *available at http://www.sec.gov/news/press/2008/2008-234.htm.*

[62] Investment Company Institute, SEC Staff No-Action Letter (Oct. 10, 2008). This letter is available on our Web site at *http://www.sec.gov/divisions/investment/noaction/2008/ICI101008.htm.* The letter by its terms did not apply, however, to shadow pricing if particular circumstances (such as the impairment of the creditworthiness of the issuer) suggested that amortized cost was not appropriate. The staff position also was limited to portfolio securities that were ''first tier securities'' under rule 2a–7 and that the fund reasonably expected to hold to maturity. The letter applied to shadow pricing procedures through January 12, 2009.

[63] On September 10, 2008, six days prior to The Reserve Fund's announcement, approximately $1.38 trillion was invested in institutional prime (taxable) money market funds. *See* ICI Mutual Fund Historical Data, *supra* note 47. On October 8, 2008, approximately $962 billion was invested in those funds. *See id.* In addition, between September 10 and September 17, the assets of these funds fell by approximately $193 billion. *See id.*

[64] This estimate is based on no-action requests and other conversations with our staff during this time period.

[65] The Credit Crisis, *supra* note 46, at 1 (''After experiencing more than $400 billion in outflows over a short period of time, money funds had little appetite for commercial paper; even quality issuers discovered they could not access the commercial paper market * * *.'').

[66] An interest rate spread measures the difference in interest rates of debt instruments with different risk. *See* Markus K. Brunnermeier, *Deciphering the Liquidity and Credit Crunch 2007–2008,* 23 J. Econ. Perspectives 77, 85, Winter 2009 (''Brunnermeier'').

[67] *See id.*; David Oakley, *LIBOR Hits Record Low as Credit Fears Ease,* Fin. Times, May 5, 2009. For example, the ''TED'' spread (the difference between the risk-free U.S. Treasury Bill rate and the riskier London Interbank Offering Rate (''LIBOR'')), normally around 50 basis points, reached a high of 463 basis points on October 10, 2008. *See* David Serchuk, *Banks Led by the TED,* Forbes, Jan. 12, 2009.

[68] Taxable money market fund average weighted average maturities shortened to 40–42 days during October 2008 from 45–46 days shortly prior to this period based on analysis of data from the iMoneyNet Money Fund Analyzer database.

[69] The TED spread was 52 basis points on May 29, 2009. The LIBOR–OIS spread (the difference between three-month dollar London Interbank Offered Rate and the overnight index swap rate) was 45 basis points. *See* Lukanyo Mnyanda, *Libor Declines for Second Day on Signs Economic Slump is Easing,* Bloomberg, May 29, 2009, *available at http://www.bloomberg.com/apps/news?pid=20670001&sid=agpZArg2paJE.* Prior to the start of the financial turbulence in the summer of 2007, the TED spread averaged approximately 25–50 basis points and the three-month LIBOR–OIS spread averaged 7–9 basis points. *See* historical chart of TED spread *available at http://www.bloomberg.com/apps/cbuilder?ticker1=.TEDSP%3AIND;* Simon Kwan, *Behavior of LIBOR in the Current Financial Crisis,* FRBSF Economic Letter (Federal Reserve Bank of San Francisco), Jan. 23, 2009, at 2–3, *available at http://www.frbsf.org/publications/economics/letter/2009/el2009-04.pdf.*

[70] *See* Bryan Keogh, John Detrixhe & Gabrielle Coppola, *Coca-Cola Flees Commercial Paper for Safety in Bonds,* Bloomberg, Mar. 17, 2009, *available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=atxKQSJUp6RE* (noting that certain companies are issuing long-term debt to replace commercial paper to avoid the risk of not being able to roll over their commercial paper, given the instability in short-term credit markets); Michael McKee, *Fed Credit Has Stabilized Markets, Not Fixed Them, Study Says,* Bloomberg, Mar. 6, 2008, *available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aRGBZuGYE78Y.*

[71] This information is based on analysis of data from the iMoneyNet Money Fund Analyzer database.

[72] *See* Press Release, U.S. Department of the Treasury, Treasury Announces Extension of Temporary Guarantee Program for Money Market Funds (Nov. 24, 2008), *available at http://www.treas.gov/press/releases/hp1290.htm;* Press Release, U.S. Department of the Treasury, Treasury Announces Extension of Temporary Guarantee Program for Money Market Funds (Mar. 31, 2009),

Continued

established by the Federal Reserve Board to support liquidity in the short-term market are set to expire early next year.[73] Total money market fund assets have continued to grow and now amount to approximately $3.8 trillion.[74] However, the composition of those assets has changed dramatically. Between September 10 and October 8, 2008, government money market fund assets increased by about 47 percent compared to a decrease of about 21 percent in taxable prime money market fund assets.[75] Since that time, prime money market fund assets have begun to grow again, although they remain below pre-September 2008 levels and government money market fund assets remain elevated.[76]

Finally, The Reserve Primary Fund has yet to distribute all of its remaining assets to shareholders, many of whom were placed in financial hardship as a result of losing access to their investments.[77] The dissolution of the fund has been affected by several factors, including operational difficulties and lack of liquidity in the secondary markets, and by legal uncertainties over the disposition of the remaining assets. We recently instituted an action in federal court seeking to ensure that the liquidation is effected on a fair and equitable basis,[78] and propose in this release regulatory changes designed to protect investors in a fund that breaks a dollar in the future.[79]

## II. Discussion

The severe problems experienced by money market funds since the fall of 2007 and culminating in the fall of 2008 have prompted us to review our regulation of money market funds. Based on that review, including our experience with The Reserve Fund, we today are proposing for public comment a number of significant amendments to rule 2a–7 under the Investment Company Act.

In formulating these proposals, Commission staff has consulted extensively with other members of the President's Working Group on Financial Markets, and in particular the Department of Treasury and the Federal Reserve Board, which provided support to money market funds and the short-term debt markets last fall, and which continue to administer programs from which money market funds and their shareholders benefit. We have consulted with managers of money market funds and other experts to develop a deeper understanding of the stresses experienced by funds and the impact of our regulations on the readiness of money market funds to cope with market turbulence and satisfy heavy demand for redemptions. In March, we received an extensive report from a ''Money Market Working Group'' assembled by the Investment Company Institute (''ICI Report''), which recommended a number of changes to our rule 2a–7 that it believes could improve the safety and oversight of money market funds.[80] We have also drawn from our experience as a regulator of money market funds under rule 2a–7 for more than 25 years and particularly since autumn 2007.

Our proposals, which we discuss in more detail below, are designed to increase the resilience of money market funds to market disruptions such as those that occurred last fall. The proposed rules would reduce the vulnerability of money market funds to breaking the buck by, among other things, improving money market funds' ability to satisfy significant demands for redemptions. If a particular fund does break the buck and determines to liquidate, the proposed rules would facilitate the orderly liquidation of the fund in order to protect the interests of all fund shareholders. These changes together should make money market funds (collectively) less susceptible to a run by diminishing the chance that a money market fund will break a dollar and, if one does, provide a means for the fund to orderly liquidate its assets. Finally, our proposals would improve our ability to oversee money market funds by requiring funds to submit to us current portfolio information.

Our proposals represent the first step in addressing issues we believe merit immediate attention.[81] Throughout this release, we ask comment on other possible regulatory changes aimed at further strengthening the stability of money market funds. In addition, we ask comment on some more far-reaching changes that could transform the business and regulatory model on which money market funds have operated for more than 30 years, including whether money market funds should move to a floating net asset value.[82] We expect to benefit from the comments we receive before deciding whether to propose further changes.

### *A. Portfolio Quality*

To limit the amount of credit risk to which money market funds can be exposed, rule 2a–7 limits them to investing in securities that a fund's board of directors (or its delegate pursuant to written guidelines) determines present minimal credit risks.[83] In addition, securities must at the time of acquisition be ''eligible securities,'' which means in part that they must have received the highest or second highest short-term debt ratings from the ''requisite NRSROs.''[84]

---

*available at http://www.treas.gov/press/releases/tg76.htm.*

[73] The AMLF and the CPFF will expire on February 1, 2010. *See* Press Release, Federal Reserve (June 25, 2009), *available at http://www.federalreserve.gov/newsevents/press/monetary/20090625a.htm.* The use of the AMLF peaked on October 1, 2008, with holdings of $152.1 billion. *See* Federal Reserve Board, Statistical Release H.4.1: Factors Affecting Reserve Balances (Oct. 2, 2008), *available at http://www.federalreserve.gov/releases/h41/20081002.* AMLF holdings as of April 29, 2009 stood at $3.699 billion. *See* Federal Reserve Board, Statistical Release H.4.1: Factors Affecting Reserve Balances (Apr. 30, 2009), *available at http://www.federalreserve.gov/releases/h41/20090430.*

[74] *See* ICI Trends, *supra* note 4.

[75] *See* ICI Mutual Fund Historical Data, *supra* note 47.

[76] *See id.*

[77] The Reserve Primary Fund did not make an initial partial pro rata distribution of assets until October 30, 2008. *See* Press Release, The Reserve Fund, Reserve Primary Fund Makes Initial Distribution of $26 Billion to Primary Fund Shareholders (Oct. 30, 2008). The fund has distributed approximately 90 percent of its assets. *See* Press Release, The Reserve Fund, Court Issues Order Setting Objection and Hearing Dates on Securities and Exchange Commission's Proposed Plan for Distribution of Reserve Primary Fund's Assets (June 15, 2009).

[78] *See SEC* v. *Reserve Management Co., Inc., et al.,* Litigation Release No. 21025 (May 5, 2009), *available at http://www.sec.gov/litigation/litreleases/2009/lr21025.htm.* We note that we also have filed fraud charges against several entities and individuals who operate The Reserve Primary Fund alleging that they failed to provide key material facts to investors and trustees about the fund's vulnerability as Lehman Brothers sought bankruptcy protection. *See id.*

[79] *See infra* Section II.I.

[80] ICI Report, *supra* note 6.

[81] We note that we accomplished the reforms of money market fund regulation we initiated in 1990 in two steps. *See* 1990 Proposing Release, *supra* note 22 (taxable money market funds); Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 19959 (Dec. 17, 1993) [58 FR 68585 (Dec. 28, 1993)] (tax exempt money market funds) (''1993 Proposing Release'').

[82] *See infra* Section III.A.

[83] Rule 2a–7(c)(3)(i). Although rule 2a–7 refers to determinations to be made by a fund or its board, many of these determinations under the rule may be delegated to the investment adviser or fund officers pursuant to written guidelines that the board establishes and oversees to assure that the applicable procedures are being followed. Rule 2a–7(e).

[84] Rule 2a–7(a)(10)(i) (defining ''eligible security''). If the securities are unrated, they must be of comparable quality. Rule 2a–7(a)(10)(ii). The term ''requisite NRSROs'' is defined in paragraph (a)(21) of the rule to mean ''(i) Any two NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or (ii) If only one NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the fund Acquires the security, that NRSRO.'' Thus, a security can satisfy the ratings requirement in one of four ways: (1) It is rated in the same (top two) category by any two NRSROs; (2) if it is rated by at least two NRSROs in either of the top two categories, but no two

Because of the additional credit risk that generally is represented by securities rated in the second highest, rather than the highest, NRSRO rating category, a taxable money market fund may not invest more than five percent of its total assets in ''second tier securities.'' [85] Tax exempt money market funds are limited in the same manner only with respect to second tier ''conduit securities,'' *i.e.,* municipal securities backed by a private issuer.[86]

We are also proposing a change to the provisions of rule 2a–7 that limit money market funds to investing in high quality securities. We propose to generally limit money market fund investments to securities rated in the highest NRSRO ratings category. In addition, we are seeking comment on whether to modify provisions of the rule that incorporate minimum ratings by NRSROs to reflect changes made to the federal securities laws by the Credit Rating Agency Reform Act of 2006 (''Rating Agency Reform Act'').[87]

1. Second Tier Securities

We propose to amend rule 2a–7 to allow money market funds to invest only in first tier securities. Under the proposed amendments, money market funds could ''acquire'' only ''eligible securities,'' which would be re-defined to include securities receiving only the highest (rather than the highest two) short-term debt ratings from the ''requisite NRSROs.'' [88] Funds would not have to immediately dispose of a security that was downgraded by the requisite NRSROs but, under existing provisions of rule 2a–7, the fund would have to dispose of the security ''as soon as practicable consistent with achieving an orderly disposition of the security'' unless the fund's board of directors finds that such disposal would not be in the best interest of the fund.[89]

We have considered previously the extent to which money market funds should be permitted to invest in second tier securities. In 1991, following distress at several money market funds that held defaulted commercial paper, the Commission, among other things, limited a taxable money market fund's total investment in second tier securities to five percent of the fund's portfolio assets and limited the investment in any particular issuer of second tier securities to no more than the greater of one percent of the fund's portfolio assets or $1 million.[90] At that time, commenters in favor of eliminating money market funds' investment in second tier securities argued that such securities may undergo a rapid deterioration and thus may pose risks to the fund holding such securities as well as to investor confidence in money market funds in general.[91] On the other hand, issuers of second tier securities urged the Commission not to limit money market funds' holdings of second tier securities, arguing that the Commission's concerns regarding the creditworthiness of second tier securities were misplaced and that restrictions would raise issuers' borrowing costs and discourage money market funds from holding any second tier securities.[92] Based principally on the potential risk to money market funds of holding second tier securities, we adopted the five percent and one percent limitations to limit (but not eliminate) exposure of money market funds to second tier securities and any one issuer of second tier securities.[93]

Second tier securities were not directly implicated in the recent strains on money market funds. The ICI's Money Market Working Group expressed concern to us, however, that these securities may present an ''imprudent'' risk to the stable value of money market funds because they present ''weaker credit profiles, smaller overall market share, and smaller issuer program sizes * * *'' [94] Our examination of the data discussed below suggests support for their recommendation that money market funds no longer be permitted to invest in these securities.[95]

Compared to the market for first tier securities, the market for second tier securities is relatively small. As of June 24, 2009, there was $1082.5 billion in rule 2a–7-eligible commercial paper outstanding, consisting of $1035.8 billion (95.7 percent) of first tier and $46.7 billion (4.3 percent) of second tier.[96] The size of the second tier market has remained consistently small over time.[97]

In addition, second tier securities present potentially substantially more risk than first tier securities. As the following chart shows, during the market disruptions of last fall, second tier securities experienced significantly wider credit spreads than first tier securities.[98]

---

NRSROs assign the same rating, the lower rating is assigned; (3) it is rated by only one NRSRO, in one of the top two categories; or (4) it is an unrated security that the board or its delegate determines to be of comparable quality to securities satisfying the rating criteria. The terms ''rated security'' and ''unrated security'' are defined in paragraphs (a)(19) and (a)(28) of rule 2a–7, respectively.

[85] Rule 2a–7(c)(3)(ii)(A). *See also* rule 2a–7(a)(10) (defining ''eligible security''), (a)(22) (defining ''second tier security'' as any eligible security that is not a first tier security), and (a)(12) (defining ''first tier security'' as, among other things, any eligible security that, if rated, has received the highest short-term term debt rating from the requisite NRSROs or, if unrated, has been determined by the fund's board of directors to be of comparable quality). *See also* 1990 Proposing Release, *supra* note 22, at Section II.1.b.

[86] Rule 2a–7(c)(3)(ii)(B). *See also* rule 2a–7(a)(7) (defining ''conduit security'').

[87] Credit Rating Agency Reform Act of 2006, Pub. L. 109–291, 120 Stat. 1327.

[88] *See* rule 2a–7(a)(1) (defining acquisition (or acquire) as any purchase or subsequent rollover, but not including the failure to exercise a demand feature); proposed rule 2a–7(a)(11)(iii) (defining eligible security); proposed rule 2a–7(c)(3) (portfolio quality). Because eligible securities would no longer be divided into first tier and second tier securities, both of those terms would be deleted from the rule, as would provisions relating specifically to second tier securities. *See* rule 2a–7(a)(12), (a)(22), (c)(3)(ii), (c)(4)(i)(C), (c)(4)(iii)(B), (c)(6)(i)(A), and (c)(6)(i)(C). We would therefore amend the definition of eligible security to require that securities receive ''the highest,'' as opposed to ''one of the two highest'' short-term rating categories, as the current definition provides, and delete other references in the rule to the second highest rating category. *See* proposed rule 2a–7(a)(11)(iii). The definition of eligible security also would be expanded to include two types of securities, securities issued by a money market fund and ''Government securities,'' that were formerly part of the definition of first tier securities. *See* proposed rule 2a–7(a)(11)(i) and (ii); *see also* rule 2a–7(a)(14) (defining Government security). Unrated securities determined by the board of directors of the fund or its delegate to be of comparable quality also would still be eligible securities. *See* proposed rule 2a–7(a)(11)(iv).

[89] *See* rule 2a–7(c)(6)(ii); proposed rule 2a–7(c)(7)(ii).

[90] *See* rule 2a–7(c)(3)(ii)(A), (c)(4)(i)(C)(1). *See also* 1991 Adopting Release, *supra* note 20.

[91] *See* 1991 Adopting Release, *supra* note 20, at n.36 and accompanying text. Most commenters representing the mutual fund industry supported or did not oppose the limitations we proposed. *Id.* at n.35 and accompanying text.

[92] *See id.* at text following n.35.

[93] *See id.* at n.35–37 and accompanying text; 1990 Proposing Release, *supra* note 22, at n.33 and accompanying text.

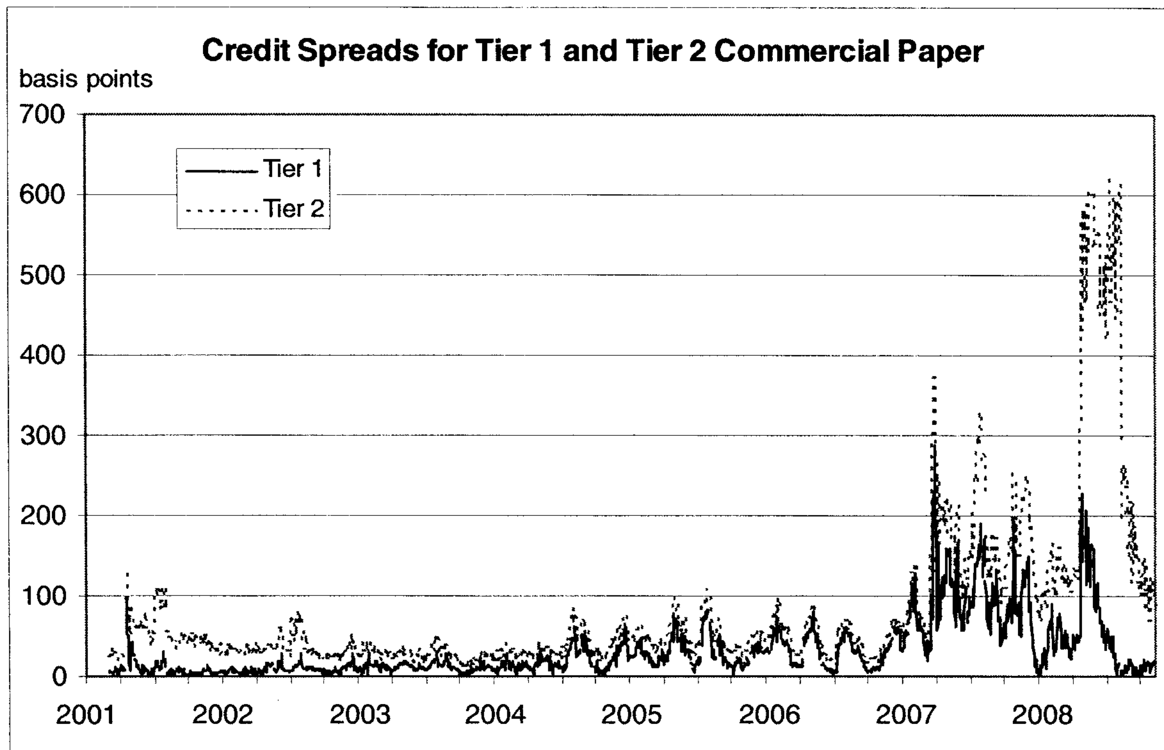
[94] ICI Report, *supra* note 6, at 101.

[95] *Id.* at 100.

[96] *See* Federal Reserve Board Commercial Paper Outstanding Chart, *available at http://www.federalreserve.gov/releases/cp/outstandings.htm* (showing weekly levels of rule 2a–7-eligible commercial paper outstanding).

[97] *See* Federal Reserve Board Commercial Paper Data Download Program, *available at http://www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP* (select year-end outstandings from the preformatted data package menu and follow the instructions for download). Over the last eight years, the market for second tier securities on average has represented only 4.6 percent of the rule 2a–7-eligible commercial paper market.

[98] *See* Federal Reserve Board Commercial Paper Rates Chart, *available at http://www.federalreserve.gov/releases/cp/default.htm. See also* Frank J. Fabozzi, The Handbook of Fixed Income Securities, at 4 (7th ed. 2005) (''Default risk or credit risk refers to the risk that the issuer of a bond may be unable to make timely payment of principal or interest payments * * *. The spread between Treasury securities and non-Treasury securities that are identical in all respects except for quality is referred to as a *credit spread* or *quality spread.*'').




Source of Data: Federal Reserve, available at http://www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP.

Second tier securities as an asset class also are of weaker credit quality in terms of interest coverage ratios, debt coverage ratios, and debt to equity ratios.[99] These data strongly suggest that second tier securities generally present additional risks to a money market fund. This is a conclusion that may have been reached by money market fund managers, most of which (as described below) do not invest in second tier securities. In light of the risks that second tier securities generally present to money market funds, and the consequences to funds and fund investors of breaking a dollar, we are proposing to limit funds to investing in first tier securities. We believe such a limitation would make it less likely that a money market fund would hold a problematic security, or a security that would lose significant value as a result of market disruptions.

It does not appear that amending rule 2a–7 to eliminate money market funds' ability to acquire second tier securities would be materially disruptive to funds. Prior to our amendments to rule 2a–7 in 1991, non-government money market funds held more than eight percent of their assets in second tier securities.[100] After we restricted the amount of second tier securities money market funds could buy, the funds soon reduced their holdings to almost zero.[101] Our staff's review of money market fund portfolios in September 2008 found that second tier securities represented only 0.4 percent of the $3.6 trillion held by the funds (approximately $14.6 billion).

We request comment on our proposal to eliminate the ability of money market funds to invest in second tier securities. What would be the impact on funds? Would the benefit of reducing credit risk by eliminating the ability of money market funds to invest in second tier securities outweigh any potential diversification benefits that second tier securities may otherwise provide to money market funds? What, if any, diversification benefits do money market funds currently receive from investing in second tier securities? Would this change have a significant effect on yields?

Would there be a proportionately greater impact of eliminating second tier securities on smaller or less established money market funds or on particular types of funds (*e.g.,* single-state tax exempt funds)? If the proposal to eliminate funds' ability to hold second tier securities is adopted, what transition period should we provide money market funds to dispose of their existing second tier holdings in an orderly manner? Should we allow funds that hold second tier securities after the amended rule becomes effective to continue to hold such securities until maturity?

Are there alternatives to eliminating entirely the ability of a money market fund to invest in second tier securities? For example, should money market funds instead be limited to investing in second tier securities (i) with a maximum maturity of, for example, 45 days, or (ii) as a smaller portion of fund assets, such as two percent of the total assets, or (iii) a combination of both? A security with a shorter maturity presents less credit risk to a fund (because the exposure is shorter) and less liquidity risk (because cash will be available sooner). Would such an approach address, or at least partly address, the concerns raised by the ICI Report and in this Release?[102] Could additional credit risk analysis or other procedures be imposed with respect to second tier securities to address these concerns?

[99] *See* Standard & Poor's, CreditStats: 2007 Adjusted Key U.S. Industrial and Utility Financial Ratios, at 6, Table 3 (Sept. 10, 2008), *available at http://www2.standardandpoors.com/spf/pdf/fixedincome/CreditStats_2007_Adjusted_Key_Financial_Ratios.pdf* (showing A–2 rated commercial paper had EBIT interest coverage of 7.2x, free operating cash flow to debt of 16.7%, and debt to debt plus equity of 45.1%, compared to A–1 averages of 11.5x, 31.3%, and 37.1%, respectively, represented as three-year (2005–2007) averages).

[100] *See* Crabbe & Post, *supra* note 15, at 11, Table 2.

[101] *See id.* at 11–12.

[102] *See* ICI Report, *supra* note 6, at 100–101.

2. Eligible Securities

a. Use of NRSROs

As discussed above, rule 2a–7 currently requires a money market fund to limit its portfolio investments to eligible securities, *i.e.,* short-term securities that at the time of acquisition have received ratings from the ''requisite NRSROs'' in one of the two highest short-term debt rating categories and securities that are comparable to rated securities.[103]

A determination that a security is an eligible security as a result of its NRSRO ratings is a necessary but not sufficient finding in order for a fund to acquire the security.[104] References to NRSRO ratings in rule 2a–7 and other regulations were designed to provide a clear reference point to regulators and market participants. The reliability of credit ratings, however, has been questioned, in particular in light of developments during the recent financial crisis. As a result, there have been calls to produce higher quality ratings. Last year, we proposed to eliminate the use of NRSRO ratings in rules under the Investment Company Act, including rule 2a–7, and instead to rely solely on the fund manager's credit risk determination.[105] In 2003, in a concept release seeking comment on various issues relating to credit rating agencies, we also asked whether credit ratings should be used as a minimum objective standard in rule 2a–7. Most commenters who addressed the specific question in 2003 supported retaining the ratings requirement in rule 2a–7.[106] One commenter asserted that ''[t]he combination of this objective test with the 'subjective test' (credit analysis performed by the adviser to the money market fund) provides an important complementary rating structure under Rule 2a–7.'' [107] Similarly, in our proposal last year, a substantial majority of commenters disagreed with the proposed elimination of the ratings requirement.[108] The ICI Report summed up the views of many of these commenters, asserting that elimination of the NRSRO ratings' ''floor * * * would remove an important investor protection from Rule 2a–7, introduce new uncertainties and risks, and abandon a regulatory framework that has proven to be highly successful.'' [109] A few commenters supported removing the ratings requirement in 2003 and as proposed in 2008, however. One of these commenters noted that ''one of the core causes of the sub-prime crisis was dependence on inaccurate and unsupportable credit ratings.'' [110]

In light of recent market developments, we request that commenters again address whether or not the approach we proposed last year would provide safeguards with respect to credit risk that are comparable to the continued inclusion of NRSRO references in the rule. What other alternatives could we adopt to encourage more independent credit risk analysis and meet the regulatory objectives of rule 2a–7's requirement of NRSRO ratings? Are there additional factors that we should consider with respect to last year's proposal? Should we consider establishing a roadmap for phasing in the eventual removal of NRSRO references from the rule? We are also considering an approach under which a money market fund's board would designate three (or more) NRSROs that the fund would look to for all purposes under rule 2a–7 in determining whether a security is an eligible security.[111] In addition, the board would be required to determine at least annually that the NRSROs it has designated issue credit ratings that are sufficiently reliable for that use.[112] We request comment on an approach in which the fund board designates NRSROs. Would the inclusion of a number of ''designated NRSROs'' improve rule 2a–7's use of NRSRO ratings as a threshold investment criterion and be consistent with the goals of Congress in passing the Rating Agency Reform Act? [113] What are the advantages and disadvantages of such an approach? Should funds be required to designate a minimum number of NRSROs to use in determining thresholds for Eligible Securities or in monitoring ratings? If so, would at least three be the appropriate number, as some have suggested? [114] Would more be appropriate to address these purposes (*e.g.,* four, five or six)? Should we permit fund boards to designate different NRSROs with respect to different types of issuers of securities in which the fund invests? Should the funds be required to disclose these designated NRSROs in their statements of additional information? [115]

What impact would a requirement that the fund board designate NRSROs have on competition among NRSROs? Would NRSROs compete through ratings to achieve designation by money market funds? Given that the staff believes it is reasonable to assume that the three NRSROs that issued almost 99 percent of all outstanding ratings across all categories that were issued by the 10 registered NRSROs as of June 2008,[116]

[103] *See supra* note 84 and accompanying text. A ''rated security'' generally means a security that (i) has received a short-term rating from an NRSRO, or whose issuer has received a short-term rating from an NRSRO with respect to a class of debt obligations that is comparable in priority and security with the security; or (ii) is subject to a guarantee that has received a short-term rating from an NRSRO, or a guarantee whose issuer has received a short-term rating from an NRSRO with respect to a class of debt obligations that is comparable in priority and security with the guarantee. Rule 2a–7(a)(19).

[104] The rule also requires fund boards (which typically rely on the fund's adviser) to determine that the security presents minimal credit risks, and specifically requires that determination ''be based on factors pertaining to credit quality in addition to any ratings assigned to such securities by an NRSRO.'' Rule 2a–7(c)(3)(i).

[105] *See, e.g.,* References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28327 (July 1, 2008) [73 FR 40124 (July 11, 2008)] (''NRSRO References Proposal'').

[106] *See, e.g.,* Comment Letter of Fidelity Investments (July 25, 2003) (File No. S7–12–03). Comment letters on File No. S7–12–03 are available at *http://www.sec.gov/rules/concept/s71203.shtm*l.

[107] Comment Letter of Denise Voigt Crawford, Securities Commissioner, Texas State Securities Board (July 28, 2003) (File No. S7–12–03).

[108] *See, e.g.,* Comment Letter of T. Rowe Price Family of Funds (Sept. 5, 2008) (File No. S7–19–08). Comment letters on File No. S7–19–08 are available at *http://www.sec.gov/comments/s7-19-08/s71908.shtml.*

[109] *See* ICI Report, *supra* note 6, at 81.

[110] *See* Comment Letter of Professor Frank Partnoy (received Sept. 5, 2008) (File No. S7–19–08).

[111] Commenters on our NRSRO References Proposal and the ICI Report recommended similar approaches. *See* Comment Letter of Federated Investors, Inc. (Sept. 5, 2008) (File No. S7–19–08) (suggesting that rule 2a–7 require the board or its delegate to select by security type at least three NRSROs on which the fund would rely under the rule); Comment Letter of OppenheimerFunds, Inc. (Sept. 4, 2008) (File No. S7–19–08) (suggesting the rule allow fund boards to designate (presumably after considering any recommendations of the investment manager) the identity and number of NRSROs whose ratings will be used to determine eligible portfolio securities); ICI Report, *supra* note 6, at 82 (recommending the fund designate three or more NRSROs that the fund would use in determining the eligibility of portfolio securities). *See also* Comment Letter of Stephen A. Keen on behalf of Federated Investors, Inc. (Mar. 12, 2007) (File No. S7–04–07) (in response to our 2007 proposal on oversight of NRSROs, asserting that investment advisers should be free to choose which NRSROs they will rely upon and monitor only their ratings).

[112] The only time that funds would be required to look to all NRSROs under this approach would be, as under the current rule, in determining whether a long-term security with a remaining maturity of 397 calendar days or less that does not, and whose issuer does not, have a short-term rating is an eligible security. *See infra* section II.A.2.b.

[113] *See* Senate Committee on Banking, Housing, and Urban Affairs, Credit Rating Agency Reform Act of 2006, S. Rep. No. 109–326, at 2 (2006) (''Senate Report 109–326'') (purposes of the Act include improving the quality of NRSRO credit ratings by fostering accountability, transparency, and competition in the credit rating industry).

[114] *See supra* note 111.

[115] *See* Part B of Form N–1A.

[116] The staff's belief is based on its report that three NRSROs issued almost 99 percent of all the outstanding ratings across all categories that were

Continued

also issued well over 90 percent of all outstanding ratings of short term debt, and in light of concerns about enhancing competition among NRSROs, should the minimum number of designated NRSROs be greater than three, such as four, five, or six? [117] What are the advantages and disadvantages of requiring boards to monitor the ratings issued by all NRSROs? Should rule 2a–7 specify certain minimum policies and procedures for monitoring NRSROs? Should money market fund boards be permitted to designate credit rating agencies or credit evaluation providers that are not registered as NRSROs with the Commission under the Securities Exchange Act of 1934 and the rules we have adopted under those provisions? [118] Should a board be solely responsible for designating and annually reviewing a designated NRSRO or should we permit delegation of this responsibility? How many NRSROs would money market fund boards be likely to evaluate before making their designations? After a fund board had designated NRSROs, what incentives would the board have to change the designated NRSROs?

We request comment on the impact of any of these approaches on funds and their ability to maintain a stable net asset value. Would any particular requirement help funds to better determine whether a security is an eligible security? We also request comment on the potential impact on competition among NRSROs.

b. Long-Term Unrated Securities

Rule 2a–7 permits money market funds to invest in a long-term security with a remaining maturity of 397 calendar days or less (''stub security'') that is an unrated security (*i.e.,* neither the security nor its issuer or guarantor has a short-term rating) unless the security has received a long-term rating from any NRSRO that is not within the NRSRO's three highest categories of long-term ratings.[119] Under rule 2a–7, the measure of quality is the rating given to the issuer's short-term debt. In the absence of a short-term rating, the minimum long-term rating is designed to provide an independent check on a fund's quality determination.[120] In light of the changes we are proposing above to increase the portfolio quality standards of the rule, we propose to permit money market funds to acquire such securities only if they have received long-term ratings in the highest two ratings categories to more narrowly limit the credit risk to which a money market fund may be exposed.[121] As under the current rule, fund boards would continue to be required to determine that such a security is ''of comparable quality'' to a rated security if it met these proposed conditions.[122]

We request comment on this proposed change. Given our proposal to increase the quality standards of the rule, is the proposed change appropriate? Should we consider permitting funds to acquire these stub securities only if they have received long-term ratings in the highest rating category? What impact would the proposed amendment have on money market funds' current portfolio holdings? We request commenters expressing views on this change to provide us with data identifying the relationship between the long-term ratings on these stub securities and short-term ratings.

3. Credit Reassessments

Rule 2a–7 currently requires a money market fund's board of directors to promptly reassess whether a portfolio security continues to present minimal credit risks if, subsequent to its acquisition by the fund, (i) the security has ceased to be a first tier security (*e.g.,* the security is downgraded to second tier by one of the requisite NRSROs), or (ii) the fund's adviser becomes aware that an unrated or second tier security has received a rating from any NRSRO below the second highest short-term rating category.[123] In light of the proposed elimination of second tier securities from the definition of eligible security, we propose to amend rule 2a–7 so the only circumstance in which the fund's board of directors would be required to reassess whether a security continues to present minimal credit risks would be if, subsequent to its acquisition by the fund, the fund's money market fund adviser becomes aware that an unrated security has received a rating from any NRSRO below the highest short-term rating category.[124]

We request comment on whether these are appropriate circumstances under which to require a reassessment in light of our proposal to eliminate the ability of money market funds to invest in second tier securities.

4. Asset Backed Securities

Rule 2a–7 contains provisions that specifically address asset backed securities (''ABSs''),[125] including the circumstances under which an ABS is an eligible security,[126] the maturity of an ABS,[127] and how a fund must treat such an investment under the diversification provisions.[128] The rule, however, does not specifically address how a fund board (or its delegate) should determine that an investment in an ABS (or other potential portfolio investment) presents minimal credit risks, nor does it specifically address liquidity issues presented by a money market fund's investment in an ABS.

Both such matters were raised in 2007 by money market funds' investment in SIVs, which we discussed briefly above. SIVs issued commercial paper to finance a portfolio of longer term, higher yielding investments, including residential mortgages. Unlike other commercial paper programs, SIVs typically did not have access to liquidity facilities to protect commercial paper investors (including money market funds) against the risk of the issuer's inability to reissue (or ''rollover'') commercial paper caused by either a credit event of the issuer or a disruption in the commercial paper

issued by the 10 registered NRSROs as of June 2008. *See* SEC, Annual Report on Nationally Recognized Statistical Rating Organizations at 35 (June 2008) (''2008 NRSRO Report'').

[117] According to the ICI Report, requiring money market funds to designate at least three NRSROs whose ratings the fund would use in determining eligible portfolio securities could encourage competition among NRSROs to achieve designation by money market funds. *See* ICI Report, *supra* note 6, at 82.

[118] *See* 15 U.S.C. 78o–7; 17 CFR 240.17g–1 (rules governing the registration of NRSROs).

[119] Rule 2a–7(a)(10)(ii)(A). Nonetheless, the security may be an eligible security if it has received a long-term rating from the requisite NRSROs in one of the three highest long-term rating categories and (as with any unrated security that is an eligible security) is of comparable quality to a rated security. *Id.*

[120] *See* 1991 Adopting Release, *supra* note 20, at text accompanying nn.65–68.

[121] Proposed rule 2a–7(a)(11)(iv)(A). Similar to the provision in the current rule, the security might be an eligible security even if it received a long-term rating below the two highest long-term rating categories if the requisite NRSROs rate the security in one of the two highest long-term rating categories. *Id.*

[122] Proposed rule 2a–7(a)(11)(iv).

[123] Rule 2a–7(c)(6)(i)(A)(1) and (2).

[124] Proposed rule 2a–7(c)(7)(i)(A). As under the current rule, the proposed rule amendment would not require, and we would not expect, investment advisers to subscribe to every rating service publication in order to comply with the requirement that the board reassess when the fund's adviser becomes aware that any NRSRO has rated an unrated security below its highest rating. We would expect an investment adviser to become aware of a subsequent rating if it is reported in the national financial press or in publications to which the adviser subscribes. *See* 1991 Adopting Release, *supra* note 20, at n.71.

[125] An asset backed security is defined very generally to mean a fixed income security that entitles its holders to receive payments that depend primarily on the cash flow from financial assets underlying the asset backed security. *See* rule 2a–7(a)(3).

[126] *See* rule 2a–7(a)(10)(ii)(B).

[127] *See* rules 2a–7(a)(8)(ii) and 2a–7(d).

[128] *See* rule 2a–7(c)(4)(ii)(D).

market.[129] When they could no longer rollover their debt beginning in 2007, those SIVs, unable to secure liquidity support from sponsoring banks, were forced to begin selling the vehicles' assets into depressed markets to pay maturing debt and to begin winding down their operations. SIV credit ratings deteriorated rapidly as they deleveraged, placing pressure on valuations of SIV securities held by money market funds. We understand that eventually most funds holding SIV securities not supported by a large bank entered into agreements with affiliates of the fund to support the fund's stable net asset value per share.

We request comment on whether, and if so how, we should amend rule 2a–7 to address risks presented by SIVs or similar ABSs. As discussed above, rule 2a–7 requires that money market funds only invest in securities that the board of directors or its delegate determines present minimal credit risks.[130] The Commission has stated that ''[d]etermining that an ABS presents minimal credit risks requires an examination of the criteria used to select the underlying assets, the credit quality of the put providers, and the conditions of the contractual relationships among the parties to the arrangement. When an ABS consists of a large pool of financial assets, such as credit card receivables or mortgages, it may not be susceptible to conventional means of credit risk analysis because credit quality is based not on a single issuer but on an actuarial analysis of a pool of financial assets.'' [131] We also said, however, that we were concerned that ''fund credit analysts may be unable to perform the thorough legal, structural and credit analyses required to determine whether a particular ABS involves inappropriate risks for money market funds'' and, as a result, required that any ABS in which a money market fund invested be rated by an NRSRO because of NRSROs' role in assuring that the underlying ABS assets are properly valued and provide adequate asset coverage for the cash flows required to fund ABSs.[132]

As discussed above, beginning in 2007, SIV securities were rapidly downgraded by NRSROs revealing money market funds' varying minimal credit risk determinations with respect to these securities. In light of this experience, should we provide additional guidance to money market funds on the required minimal credit risk evaluation with respect to ABSs? We believe that part of this analysis, when evaluating any security, should include an evaluation of the issuer's ability to maintain its promised cash flows which, in the case of an asset backed security, would entail an analysis of the underlying assets, their behavior in various market conditions, and the terms of any liquidity or other support provided by the sponsor of the security.[133] Should we amend rule 2a–7 to remove the requirement that any ABS be rated by an NRSRO in order to be an eligible security for money market funds in light of the NRSROs' recent rapid downgrading of these securities? Under our proposed liquidity requirements (discussed below), the liquidity features of an ABS would have to be considered in determining whether the fund holds sufficiently liquid assets to meet shareholder redemptions.[134]

We request comment on whether rule 2a–7 should explicitly require fund boards of directors (or their delegates) to evaluate whether the security includes any committed line of credit or other liquidity support. Are there other factors that we should require money market fund boards to evaluate when determining whether SIV investments or other new financial products pose minimal credit risks? We note that some money market funds invested more significantly in SIV securities while other money market funds avoided such investments entirely. Are there facets of the credit analysis that led certain money market funds to avoid such investments that should be incorporated explicitly into rule 2a–7? [135] Should we limit money market funds to investing in ABSs that the manager concludes can be paid upon maturity with existing cash flow, *i.e.,* the payment upon maturity is not dependent on the ability of the special purpose entity to rollover debt? Alternatively, should the rule itself require ABSs to be subject to unconditional demand features to be eligible securities? [136]

### *B. Portfolio Maturity*

Rule 2a–7 restricts the maximum remaining maturity of a security that a money market fund may acquire, and the weighted average maturity of the fund's portfolio, in order to limit the exposure of money market fund investors to certain risks, including interest rate risk. The Commission is proposing changes to the rule's maturity limits to further reduce such risks, as discussed below. First, we propose to reduce the maximum weighted average portfolio maturity permitted by the rule. Second, we propose a new maturity test that would limit the portion of a fund's portfolio that could be held in longer term variable- or floating-rate securities. Third, we propose to delete a provision in the rule that permits certain money market funds to acquire Government securities with extended maturities of up to 762 calendar days. We are also requesting comment on other ways of adjusting the rule's maturity provisions in order to accomplish our goal of decreasing the risks associated with a money market fund holding longer term investments.

#### 1. Weighted Average Maturity

Rule 2a–7 requires a money market fund to maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value or price per share, but in no case greater than 90 days.[137] We adopted this provision because securities that have shorter periods remaining until maturity (and are of higher quality) generally exhibit a low level of volatility and thus provide a greater assurance that the money market fund will continue to be able to maintain a stable share price.[138]

[129] For a discussion of the evolution of the asset backed commercial paper market and SIV securities during this period, *see generally* Jim Croke, *New Developments in Asset-Backed Commercial Paper* (2008), at 2–4, *available at http://www.orrick.com/fileupload/1485.pdf*.

[130] Rule 2a–7(c)(3)(i).

[131] 1993 Proposing Release, *supra* note 81, at text accompanying nn.108–109.

[132] *Id.* at nn.110–112 and accompanying text.

[133] The ICI Report recommended that we amend rule 2a–7 to require money market fund advisers to adopt a ''new products committee.'' *See* ICI Report, *supra* note 6, at 79–80. Although such committees may be useful, their usefulness would turn on what might be a ''new product'' as well as the judgment of its members, whose judgment is today required to be brought to bear on whether the security presents minimal credit risks.

[134] *See infra* Section II.C.

[135] The staff's recent examinations of money market funds indicate that credit analysts for money market funds that invested in SIVs that subsequently defaulted appear to have had access to the same basic set of information on SIVs as did analysts at money market funds that did not and that the judgment of these credit analysts regarding minimal creditworthiness of the SIVs that subsequently defaulted appeared to have been different. The staff's exams also appear to indicate that credit analysts for money market funds that invested in SIVs that subsequently defaulted placed less emphasis on the length of time that payment experience was available on assets in the collateral pool and they were willing to accept sub-prime mortgage credits as a seasoned asset class. In addition, their decision, in part, may have been influenced by the greater amount of over-collateralization of the collateral pools and the high yields paid by notes supported by sub-prime credits.

[136] Rule 2a–7(a)(26) defines an ''unconditional demand feature'' as a ''demand feature'' that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security or securities.

[137] *See* rule 2a–7(c)(2)(iii).

[138] *See* 1983 Adopting Release, *supra* note 3, at n.7 and accompanying text.

Having a portfolio weighted towards securities with longer maturities poses several risks to a money market fund. First, as we have noted in the past, a longer weighted average maturity increases a fund's exposure to interest rate risk.[139] Second, and as we discuss in more detail below, longer maturities also amplify the effect of widening credit and interest rate spreads on a fund.[140] Finally, a fund holding securities with longer maturities generally is exposed to greater liquidity risk, because fewer securities mature on a daily or weekly basis. Perhaps in recognition of these risks, few fund managers maintain weighted average maturity at or near the maximum permissible 90 days.[141]

In view of the extraordinary market conditions we have witnessed recently, the Commission is concerned that the 90-day maximum weighted average maturity under the rule may be too long. Particularly during the market events of last fall, funds with shorter portfolio maturities were much better positioned to withstand heavy redemptions, because a greater portion of their portfolios matured each week and provided cash to pay to redeeming investors. They also were better able to withstand increased credit spreads in certain financial sector notes because of the shorter period of exposure to such distressed securities. Finally, interest rate spreads on longer maturity securities widened to a much greater degree than interest rate spreads on shorter maturity securities.[142]

The ICI Report recommended reducing the maximum weighted average maturity to 75 days.[143] Historically, however, most funds have maintained shorter maturities. During the last 20 years, the average weighted average maturity of taxable money market funds (as a group) has never exceeded 58 days.[144] As of June 16, 2009, it was 53 days.[145] Some money market funds have, from time to time, extended their maturities substantially longer than the average to gain a yield advantage, anticipating declining or stable interest rates. By doing so, these funds assumed greater risk and would be more likely to experience losses that could result in their breaking the buck if interest rates rise, credit markets do not behave as they expect, or they receive substantial redemption requests.

Most European money market funds with stable share prices (many of which are domiciled in Ireland) are limited to 60-day weighted average maturities.[146] So are money market funds rated highly by the NRSROs.[147] In light of these considerations, we believe that a shorter period may be appropriate. Accordingly, we propose that rule 2a–7 be amended to impose a 60-day weighted average maturity limit.[148]

We request comment on the proposed 60-day weighted average maturity limit. Would it decrease portfolio volatility and increase fund liquidity, as we suggest? What would be the anticipated effect on money market fund yields? Would a negative effect on yields make money market funds less attractive to investors? Should a different weighted average maturity limit apply, such as 45 days or 75 days? We request that commenters provide us with data demonstrating the effect that alternative weighted average maturity limits would have had on portfolios of money market funds during the recent economic turmoil.

2. Weighted Average Life

We propose to add to rule 2a–7 a new maturity test, which would limit the weighted average life maturity of portfolio securities to 120 days.[149] As explained further below, the weighted average life of a portfolio would be measured without regard to a security's interest rate reset dates, and thus would limit the extent to which a fund could invest in longer term securities that may expose a fund to interest rate spread risk and credit spread risk.[150]

Generally, under rule 2a–7 the maturity of a portfolio security is the period remaining until the date on which the principal must unconditionally be repaid according to its terms (its final ''legal'' maturity) or, in the case of a security called for redemption, the date on which the redemption payment must be made.[151] The rule contains exceptions from this general approach for specific types of securities, which are referred to as the ''maturity shortening'' provisions.[152] Among these exceptions are three provisions that allow a fund to treat a variable- or floating-rate security as having a maturity equal to the time remaining to the next interest rate reset

[139] *See* 1990 Proposing Release, *supra* note 22, at text accompanying n.60. *See also* Standard & Poor's, Money Market Fund Ratings Criteria, at 21 (2007) *available at http://www2.standardandpoors.com/spf/pdf/events/MMX709.pdf* (''S&P 2007 Ratings Criteria'') (''The portfolio's weighted average maturity (WAM) is a key determinant of the tolerance of a fund's investments to rising interest rates. In general, the longer the WAM, the more susceptible the fund is to rising interest rates. A fund comprised entirely of Treasury securities with a WAM of 45 days could withstand approximately twice the interest rate increase than could a fund with a 90-day WAM, leaving all other factors aside.''); Fabozzi, *supra* note 98, at 4 (''[T]he volatility of a bond's price is closely associated with maturity: Changes in the market level of [interest] rates will wrest much larger changes in price from bonds of long maturity than from otherwise similar debt of shorter life.'').

[140] *See also supra* notes 65–71 and accompanying text.

[141] According to monthly statistics kept by the Investment Company Institute, during the past 10 years, the weighted average maturities of funds in the longest maturity categories (the 90th percentile of all taxable prime money market funds) seldom have exceeded 75 days. As of April 30, 2009, these funds maintained an average weighted maturity of 67 days. These statistics are available in File No. S7–11–09.

[142] *See, e.g.,* U.S. Department of the Treasury, *Daily Treasury Yield Curve Rates, available at http://www.treasury.gov/offices/domestic-finance/debt-management/interest-rate/yield_historical_main.shtml.*

[143] *See* ICI Report, *supra* note 6, at 77.

[144] 2008 Fact Book, *supra* note 13, at Table 38. In 2009, the ICI Fact Book began presenting this information separately for taxable government and taxable non-government money market funds, which had average maturities of 49 days and 47 days, respectively, in 2008. 2009 Fact Book, *supra* note 7, at 150–51, Tables 41 & 42.

[145] *See Money Fund Report,* iMoneyNet, May 7, 2008. Average maturity for tax exempt money market funds (as a group) is even lower—24 days as of June 16, 2009. *Id.*

[146] *See* Irish Financial Services Regulatory Authority, *Valuation of Assets of Money Market Funds,* 2008 Guidance Note 1/08 (Aug. 2008), *available at http://www.financialregulator.ie/industry-sectors/funds/Documents/Guidance%20Note%20108%20Valuation%20of%20Assets%20of%20Money%20Market%20Funds.pdf* (''Financial Regulator Guidance Note 1/08''). As of April 2009, money market funds registered in Ireland managed approximately €317 billion ($419 billion) in assets. *See* Irish Financial Regulator statistics *available at http://www.irishfunds.ie/money_marketfunds.htm.* In addition, the Institutional Money Market Funds Association (''IMMFA'') requires the triple-A rated institutional money market funds sponsored by its members to comply with a Code of Practice that generally limits portfolio maturity to 60 days. *See* IMMFA, Code of Practice, Part IV., ¶ 22 (2005), *available at http://www.immfa.org/about/Codefinal.pdf.* As of February 13, 2009, IMMFA-member constant net asset value money market funds managed approximately $493 billion in assets. *See* IMMFA statistics, *available at http://www.immfa.org/stats/IMFR130209.pdf. See also* ICI Report, *supra* note 6, at 184, Appendix H.

[147] *See* S&P 2007 Ratings Criteria, *supra* note 139, at 21; Moody's Investors Service, Frequently Asked Questions about Moody's Ratings of Managed Funds, at 4 (July 20, 2005), *available at http://www.moodys.com/moodys/cust/research/MDCdocs/20/2003600000425726.pdf?search=5&searchQuery=Frequently+Asked+Questions+about+Moody*; Fitch Ratings, U.S. Money Market Fund Ratings, at 4 (Mar. 3, 2006), *available at http://www.fitchresearch.com/creditdesk/reports/report_frame.cfm?rpt_id=266376.*

[148] *See* proposed rule 2a–7(c)(2)(ii).

[149] *See* proposed rule 2a–7(c)(2)(iii).

[150] While the proposed rule would ignore interest rate resets for purposes of calculating the fund's weighted average life to maturity, a security's demand features could continue to be used in this calculation. *See, e.g.,* rule 2a–7(d)(3) and (d)(5).

[151] *See* rule 2a–7(d).

[152] *Id.* We added maturity shortening provisions to the rule in 1986; they are particularly important for tax exempt funds, which invest in municipal obligations, most of which are issued with longer maturities. *See* 1986 Adopting Release, *supra* note 19, at nn.9–10 and accompanying text.

date.[153] First, a fund may treat a short-term variable-rate security (*i.e.*, one with a remaining maturity of 397 days or less), as having a maturity equal to the earlier of the interest rate reset date or the time it would take the fund to recover the principal by exercising a demand feature.[154] Second, a fund may treat a short-term floating-rate security (*i.e.*, one with a remaining maturity of 397 days or less) as having a maturity of one day.[155] Third, a variable- or floating-rate Government security generally may be deemed to have a maturity equal to the next reset date even if it is a long-term security.[156] For purposes of calculating weighted average maturity, the rule effectively treats short-term variable- and floating-rate securities and all adjustable-rate Government securities as if they were a series of short-term obligations that are continually ''rolled over'' on the reset dates at the current short-term interest rates.

As the ICI Report explains, however, longer term adjustable-rate securities are more sensitive to credit spreads (the amount of additional yield demanded by purchasers above a risk-free rate of return to compensate for the credit risk of the issuer) than short-term securities with final maturities equal to the reset date of the longer term security.[157] Longer term adjustable-rate securities also are subject for a longer period of time to risk from widening interest rate spreads.[158] As a result, prices of longer term adjustable-rate securities could fall more than prices of comparable short-term securities in times of market turbulence. The ICI Report also notes that while adjustable-rate securities do protect a fund against changes in interest rates, permitting maturity shortening based on interest rate resets does not protect against liquidity risk to the portfolio.[159]

We are concerned that the traditional weighted average maturity measurement of rule 2a–7 does not require that a manager of a money market fund limit these risks. We understand that some money market fund portfolio managers, to protect the fund, have already begun using a weighted average maturity measurement that ignores interest rate resets.

The ICI Report confirms our observations of the behavior of prices for certain securities last fall, when money market funds found it difficult to sell at amortized cost longer term adjustable-rate securities, including securities issued by agencies of the federal government. We believe that the use of the measurement the ICI recommends, which we will call the ''weighted average life'' to maturity of a money market fund portfolio, appears to be a prudent limitation on the structure of a money market fund portfolio and would limit credit and interest rate spread risks not encompassed by the weighted average maturity restriction of rule 2a–7. As suggested by the ICI Report, we are proposing that money market funds maintain a weighted average life of no more than 120 days.[160] The Commission believes that a 120-day weighted average life requirement would provide a reasonable balance between strengthening the resilience of money market funds to market stress (*e.g.*, interest rate increases, widening spreads, and large redemptions) while not unduly restricting the funds' ability to offer a diversified portfolio of short-term, high quality debt securities.

One of the effects of a limit on the weighted average life of a portfolio would appear to be on funds that hold longer term floating-rate Government securities, which are issued by federal agencies. Consider a money market fund with a portfolio consisting 50 percent of overnight repurchase agreements and 50 percent of two-year Government agency floating-rate obligations that reset daily based on the federal funds rate. Using the reset dates as permitted by the rule's maturity shortening provisions, the portfolio would have a weighted average maturity of one day. In contrast, by applying a measurement that does not recognize resets, the portfolio would have a weighted average life of 365.5 days (*i.e.*, half of the portfolio has a one day maturity and half has a two-year maturity), which would be considerably longer than the 120-day limit we are proposing. The weighted average life limitation would provide an extra layer of protection for funds and their shareholders against spread risk, particularly in volatile markets.

We request comment on all aspects of the proposed weighted average life limitation. Is this new maturity test appropriate? Is 120 days an appropriate limit? What would be the effect on yield? Does it place too much of a constraint on the ability of money market fund advisers to effectively manage fund portfolios? Does it permit funds to assume too much risk? Would a different limit be more appropriate, such as 90 days or 150 days? Would the proposed weighted average life limitation have a material impact on the issuers of short-term debt and, if so, what would it be?

We request comment on whether there are alternative approaches to measuring these risks. We understand that some fund managers use an alternative maturity test that focuses solely on credit spread risk. Such a test not only disregards interest rate resets, but also excludes Government securities from the weighted average maturity calculation. Would this test provide a clearer indication of the overall credit spread risk of the portfolio? Are there other advantages to such an approach? If so, what would be an appropriate limit? Should it be the same as proposed weighted average life limitation of 120 days, or should it be different, such as 90 days or 150 days? We request that commenters provide us with data demonstrating the effect of such alternative credit limitations and/or weighted average life limitations on their portfolios during the recent economic turmoil.

When the Commission first adopted rule 2a–7, we explained that we were allowing Government securities to use resets for purposes of the maturity limitations under the rule because we understood that the volatility of such instruments would be no greater than the volatility of fixed interest rate instruments having a maturity equal to the period before the security's interest rate reset.[161] The Commission noted, however, that this position was based entirely upon experience with Small Business Administration guaranteed debentures—at the time the only

[153] *See* rule 2a–7(a)(13) (defining ''floating rate security'') and (a)(29) (defining ''variable rate security''). The interest rate for a variable-rate security is established on set dates, whereas the interest rate for a floating-rate security adjusts whenever a specified interest rate changes. We also may refer to variable- and floating-rate securities collectively in this Release as ''adjustable-rate'' securities.

[154] *See* rule 2a–7(d)(2). *See also* rule 2a–7(a)(8) (definition of ''demand feature'').

[155] *See* rule 2a–7(d)(4).

[156] *See* rule 2a–7(d)(1) (allowing a variable-rate Government security where the variable rate is readjusted no less frequently than every 762 days to be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate, and a floating-rate Government security to be deemed to have a remaining maturity of one day).

[157] *See* ICI Report, *supra* note 6, at 77.

[158] Interest rate spreads can widen because a variable-rate note has a fixed period of time to the next interest reset date and during that time the benchmark interest rate will likely change. Interest rate spreads can also widen because market conditions change after the security is issued such that investors may demand a greater margin to hold the security. *See* Fabozzi, *supra* note 98, at 196.

[159] *See* ICI Report, *supra* note 6, at text accompanying n.140.

[160] The proposed rule would require a money market fund to maintain a weighted average maturity not to exceed 120 days, determined without reference to the exceptions in paragraph (d) of the rule regarding interest rate resets. *See* proposed rule 2a–7(c)(2)(iii).

[161] *See* 1983 Adopting Release, *supra* note 3, at n.16.

adjustable-rate Government securities of which the Commission was aware.[162] The Commission stated that it would consider amending this provision if market experience indicates that such treatment is inappropriate.[163]

Since 1983, the number and variety of adjustable-rate Government securities have grown and, in particular, the issuance of such securities by Freddie Mac and Fannie Mae increased significantly with the growth in mortgage-backed securities. While adjustable-rate securities historically have maintained market values similar to equivalent short-term fixed-rate securities, last fall these Government securities experienced increased credit and interest rate spreads and greater volatility than Government securities with maturities similar to the reset dates of the adjustable-rate securities.[164] Further, as noted above, other short-term adjustable-rate securities also experienced increased credit and interest rate spreads and greater volatility than securities with maturities similar to the reset dates.

Currently, rule 2a–7 permits funds to rely on these reset provisions to shorten portfolio maturities only if boards or their delegates can reasonably expect that the security's market value will approximate its amortized cost on the reset date.[165] However, recent experience suggests that in times of market stress, this expected performance may not hold true. Would the weighted average life to maturity limitation adequately address this risk? Are there other alternative limitations or tests that would have mitigated this risk last fall? Should we restrict a fund's ability to use the maturity-shortening provisions of the rule to those adjustable-rate securities, including Government securities, with maximum final maturities of no more than two years, three years, or four years? What would be the impact of the weighted average life limitation on longer term adjustable-rate Government securities issuers?

3. Maturity Limit for Government Securities

The Commission is proposing to delete a provision of the rule that permits a fund that relies exclusively on the penny-rounding method of pricing to acquire Government securities with remaining maturities of up to 762 days, rather than the 397-day limit otherwise provided by the rule.[166] We are unaware of money market funds today that rely solely on the penny-rounding method of pricing, and none that hold fixed-rate Government securities with remaining maturities of two years, which we are concerned would involve the assumption of a substantial amount of interest rate risk. We request comment on our proposal to delete the provision. Are we correct that funds no longer use it? If not, are there reasons why we should retain it?

4. Maturity Limit for Other Portfolio Securities

Currently, in order to qualify as an eligible security under rule 2a–7, an individual security generally cannot have a remaining maturity that exceeds 397 days.[167] We request comment on whether we should consider reducing the maximum maturity for individual non-Government securities acquired by a money market fund from 397 days to, for example, 270 days.[168]

The length of time remaining before a security matures affects its sensitivity to increases in interest rates. In addition, a shorter maturity decreases the amount of time a fund is exposed to potential investment losses for a particular security. On the other hand, it is less clear that such a change would produce a significant increase in the safety and stability of money market funds if we were to adopt it in addition to adopting the proposed 60-day weighted average maturity and 120-day weighted average life limitations. Moreover, unlike the weighted average maturity and weighted average life limitations, a stricter maturity limitation on individual securities could have a substantially greater adverse impact on issuers of short-term obligations other than commercial paper, including issuers of tax exempt municipal securities.

What would be the effects on money market funds and the capital markets of shortening the maturity limit on individual portfolio securities to 270 days? Would there be benefits to funds from shortening the maturities of individual securities beyond the benefits that would be attained through the 60-day weighted average maturity and 120-day weighted average life limitations? What would be the likely impact on money market fund yields? What effect, if any, would shortening the maturity limit have on the supply of rule 2a–7-eligible securities? Should Government securities be excluded from a 270-day maturity limit?[169] If we were to adopt a maximum 270-day maturity for individual securities, should we include or exclude securities issued by municipalities, which typically issue debt securities with maturities of a year or more?

*C. Portfolio Liquidity*

Rule 2a–7 does not contain any provisions limiting the ability of a money market fund to hold or acquire illiquid assets.[170] Money market funds are, however, subject to section 22(e) of the Act, which requires registered investment companies to satisfy redemption requests in no more than seven days—a requirement we have construed as restricting a money market fund from investing more than 10 percent of its assets in illiquid securities.[171] Since rule 2a–7 was first adopted we have emphasized the importance of a money market fund holding sufficiently liquid securities. Money market funds often have a greater, and perhaps less predictable, volume of redemptions than other open-end investment companies.[172] And because many promise to provide redemptions sooner than other types of open-end funds—often on the same day that the redemption request is received—money market funds need

[162] *See id.*

[163] *See id.*

[164] *See* Jody Shenn, *Fannie Mae Debt Spreads Hit Records as GMAC Seeks Bank Status*, Bloomberg, Nov. 20, 2008; Jody Shenn, *Agency Mortgage-Bond Spreads Head for Worst Month on Record*, Bloomberg, Oct. 31, 2008, *available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aSc8k8D7ZMw0.*

[165] *See* rule 2a–7(a)(13) and (a)(29).

[166] *See* rule 2a–7(c)(2)(ii). We added this provision in 1991. *See* 1991 Adopting Release, *supra* note 20, at nn.53–57 and accompanying text. In a conforming change, we also propose to revise the maturity-shortening provision of the rule for variable-rate Government securities to require that the variable rate of interest is readjusted no less frequently than every 397 days, instead of 762 days as currently permitted. *See* rule 2a–7(d)(1); proposed rule 2a–7(d)(1).

[167] *See* rule 2a–7(a)(10)(i) and (c)(2)(i).

[168] A maturity limit of 270 days would be consistent with the exemption for commercial paper under section 3(a)(3) of the Securities Act of 1933 [15 U.S.C. 77c(a)(3)].

[169] We note that, while posing less credit risk, Government securities are subject to much the same risks as corporate securities from rising spreads between their market price and money market benchmarks, whether due to liquidity concerns, changes in interest rates, or other factors. For this reason some rating agencies have imposed limitations on remaining maturities of adjustable-rate Government securities held by money market funds. *See, e.g.*, S&P 2007 Ratings Criteria, *supra* note 139, at 30 (setting a two-year limit for remaining maturities of floating- or variable-rate Government securities held by money market funds for the fund to maintain the highest rating).

[170] *See* 1983 Adopting Release, *supra* note 3 at n.37 and accompanying text (''[Rule 2a–7] does not limit a money market fund's portfolio investments solely to negotiable and marketable instruments * * *.'').

[171] *See, e.g., id.* at nn.37–38 and accompanying text; 1986 Adopting Release, *supra* note 19, at n.21 and accompanying text.

[172] *See, e.g.*, 1986 Adopting Release, *supra* note 19, at text preceding and accompanying n.22; 1983 Adopting Release, *supra* note 3, at text following n.39.

sufficient liquidity to meet redemption requests on a more immediate basis.[173]

By holding illiquid securities, a money market fund exposes itself to a risk that it may be unable to satisfy redemption requests promptly, without selling illiquid securities at a loss that could impair its ability to maintain a stable net asset value per share.[174] Illiquid securities also complicate the valuation of the fund's portfolio.[175] Moreover, illiquid securities are subject to greater price volatility, exposing the fund to greater risk of breaking a buck as a result of net asset values eroding in a declining market.[176]

We have not included a specific provision in rule 2a–7 regarding liquidity because, until recently, money market funds had not experienced a severe liquidity shortfall. As discussed above, in September 2008, the markets for both traditional and asset-backed commercial paper essentially seized up. Large portions of many money market fund portfolios became illiquid when buyers of asset-backed and traditional commercial paper fled the market.[177] At the same time, many money market funds—principally institutional money market funds—received substantial redemption requests.[178] The ability of these funds to maintain a stable net asset value turned on their ability to convert portfolio holdings to cash without selling them at ''fire sale'' prices.

These events suggest to us that rule 2a–7 should be amended to address liquidity risks that money market funds face. We propose to amend rule 2a–7 to add new risk-limiting conditions designed to improve money market funds' ability to meet significant redemption demands.

1. Limitation on Acquisition of Illiquid Securities

We propose to prohibit money market funds from acquiring securities unless, at the time acquired, they are liquid, *i.e.,* securities that can be sold or disposed of in the ordinary course of business within seven days at approximately their amortized cost value.[179] In light of the risk to the fund of securities becoming illiquid as a result of market events, such as those that occurred last fall, investing any portion of the fund in securities that are already illiquid may be imprudent and thus should be prohibited by rule 2a–7.

We request comment on our proposal to preclude funds from acquiring illiquid securities. We understand that some funds make very limited investments in securities that, at the time of acquisition, are illiquid, such as insurance company funding agreements, loan participations, and structured notes that have no demand features. Would this proposed provision (which would not prohibit funds from continuing to hold securities that become illiquid after their purchase) have a significant impact on money market funds? What would be the impact on funds of not being able to buy illiquid securities? Would there be a material impact on yield?

2. Cash and Securities That Can Be Readily Converted to Cash

As discussed above, liquidity of a money market fund portfolio is critical to the fund's ability to maintain a stable net asset value. Our traditional notions of liquidity incorporated into our guidelines (discussed above) appear to be inadequate to meet the needs of a money market fund because the guidelines assume that a fund has time (up to seven days) to sell securities and that there will be a market for the securities. As noted above, money market funds typically undertake to pay their investors more quickly (frequently the same or following day). As the events of last fall demonstrated, money market funds may be unable to rely on a secondary or dealer market ready to provide immediate liquidity at amortized cost under all market conditions. Therefore we are proposing new liquidity tests that would be based on the fund's legal right to receive cash rather than its ability to find a buyer of the security.

The amount of liquidity a fund will need will vary from fund to fund and will turn on cash flows resulting from purchases and redemptions of shares. As a general matter, a fund that has some large shareholders, any one of which could redeem its entire position in a single day, will have greater liquidity needs than a retail fund that has thousands of relatively small shareholders. A fund that competes for yield-sensitive shareholders (*e.g.,* ''hot money'') through electronic ''portals'' will have substantially greater liquidity needs than a fund holding the cash of commercial enterprises that have predictable needs (such as payrolls).[180]

Our proposed formulation of a new liquidity standard is designed to take into consideration each of these factors. The proposed daily and weekly standards, discussed immediately below, would be minimum standards; the proposed general standard (which we discuss after the minimum standards) may require a fund to maintain a higher portion of its portfolios in cash or securities that can readily be converted into cash.

---

[173] *See* 1983 Adopting Release, *supra* note 3, at text following n.39.

[174] *Id.* at text preceding, accompanying and following nn.37–39.

[175] *Id.* at text preceding section titled ''Obligation of the Board to Maintain Stable Price.''

[176] S&P 2007 Ratings Criteria, *supra* note 139, at 21.

[177] *See* Board of Governors of the Federal Reserve, Report Pursuant to Section 129 of the Emergency Economic Stabilization Act of 2008: Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (undated), *available at http://www.federalreserve.gov/monetarypolicy/files/129amlf.pdf* at 1–2 (''In ordinary circumstances, MMMFs would have been able to meet these redemption demands by selling assets. At the time of the establishment of the AMLF, however, many money markets were extremely illiquid, and the forced liquidation of assets by MMMFs was placing increasing stress on already strained financial markets.''); *see generally* Board of Governors of the Federal Reserve, Monetary Policy Report to the Congress (Feb. 24, 2009), Part 2, *http://www.federalreserve.gov/monetarypolicy/mpr_20090224_part2.htm.*

[178] *See* ICI Mutual Fund Historical Data, *supra* note 47 (in the week ending September 17, the day after the Reserve Primary Fund announced that it would break a dollar, institutional money market fund assets fell by more than $119 billion while retail money market fund assets fell by $1.1 billion).

[179] Proposed rule 2a–7(c)(5). ''Liquid security'' would be defined in proposed rule 2a–7(a)(19). Last year in the NRSRO References Proposal, we proposed to define ''liquid security'' as a security that can be sold or disposed of in the ordinary course of business within seven days at approximately the cost ascribed to it by the money market fund. *See supra* note 105, at n.28 and accompanying text. *See also* 1986 Adopting Release, *supra* note 19, at text following n.21 (''The term 'illiquid security' generally includes any security which cannot be disposed of promptly and in the ordinary course of business without taking a reduced price.''). The one comment we received on the proposed definition recommended the definition refer to the ''shadow price'' rather than the ''value'' ascribed to the security by the money market fund. Most funds that rely on rule 2a–7 value their securities using the amortized cost method and thus would be required to acquire securities that can be sold or disposed of in the ordinary course of business within seven days at approximately amortized cost value.

[180] *See Money Market Funds Tackle ''Exuberant Irrationality,''* Standard & Poor's, RatingsDirect (Sept. 30, 2008), *available at http://www2.standardandpoors.com/spf/pdf/media/MoneyMarketFunds_Irrationality.pdf* (''It is likely that certain yield-sensitive institutions commonly referred to as 'hot money' accounts, moved money from one investment to another to capture a higher yielding, or seemingly safer, option. For example, after Lehman Bros. filed for bankruptcy, corporations that issued commercial paper (CP) to fund their business operations were forced to pay a significantly higher premium to obtain funding because of investor concerns with holding debt from any nongovernment issuer. The subsequent 'flight to quality' pushed some overnight and 30-day CP rates up by 0.5% (to approximately 3.5%) for issuers whose credit or financial/risk profile did not seem to change. As a result, these hot money accounts moved their investments from money market funds yielding less than 2.75%.'').

a. Minimum Daily Liquidity Requirement

*Taxable Retail Funds.* We propose to require each taxable retail money market fund to invest at least five percent of its assets in cash, U.S. Treasury securities, or securities that can provide the fund with daily liquidity, *i.e.,* securities that the fund can reasonably expect to convert to cash within a day.[181] Unlike our liquidity guidelines discussed above, which allow for a period during which a fund would be expected to seek buyers in a secondary market, these daily liquidity requirements would be significantly more demanding, requiring a portion of the funds' assets be held in ''daily liquid assets,'' which the rule would define as: (i) Cash (including demand deposits); (ii) securities (including repurchase agreements) for which the fund has a contractual right to receive cash within one business day either because the security will mature or the fund can exercise a demand feature; [182] or (iii) U.S. Treasury securities, which have historically traded in deep, liquid markets, even in times of market distress.[183]

Under the proposed amendments, a money market fund that is a ''retail fund'' could not acquire any securities other than daily liquid assets if, immediately after the acquisition, the fund would have invested less than five percent of its total assets in those assets (''minimum daily liquidity requirement'').[184] Compliance with the daily liquidity requirement would be determined at the time each security is acquired, and thus a fund would not have to dispose of less liquid securities (and potentially realize an immediate loss) if the portion of the fund held in highly liquid securities fell below five percent as a result of redemptions.

Retail money market funds experienced relatively modest redemption demands last fall, even in the midst of substantial market turbulence.[185] Thus we believe that a five percent requirement, which was recommended in the ICI Report, may be sufficient.[186] We request comment on our analysis, and whether a five percent standard is appropriate in light of the liquidity needs of retail money market funds (which we distinguish from institutional money market funds in the next section of this release). Should we consider a higher percentage, such as 10 percent or 15 percent, or a lower percentage, such as two percent or three percent? Do our proposed amendments strike the right balance between reducing liquidity risk and limiting the impact on yield? What would be the effect on yields of a lower or higher minimum daily liquidity requirement? There may be a number of factors that influence the lower redemption rates among retail investors, including investment purposes and practices, size of investments and possible differences in the information that retail as opposed to institutional investors obtain and the time when they obtain the information. We solicit comment on whether these factors did or would in the future influence the level of retail redemptions. If so, how should the proposed rule be revised to address such factors?

We also request comment on the definition of ''daily liquid assets.'' Are there other securities that are sufficiently liquid that should be included in the definition?

A fund's contractual rights to cash will be different if the fund is relying on an unconditional demand feature rather than a conditional demand feature, which the fund may not be able to exercise if there is a default or other credit event with respect to the issuer of the securities.[187] Rule 2a–7 permits both to be used to shorten the maturity of an instrument.[188] For purposes of determining the daily liquidity requirement, should the rule distinguish between securities subject to conditional and unconditional demand features?

As discussed above, compliance with the daily liquidity requirement would be determined at the time each security is acquired. A fund could acquire only daily liquid assets until the portfolio investments met the five percent daily liquidity test.[189] Because the requirement applies only at the time of acquisition, a money market fund would not have to maintain a specified percentage of its assets in daily liquid assets at all times (subject to the general liquidity requirement discussed below), even though the fund is exposed to liquidity risk at all times. We request comment on whether to impose a minimum liquidity maintenance requirement, *i.e.,* require that a money market fund maintain five percent of its portfolio at all times in daily liquid assets. What are the advantages and disadvantages of each approach?

*Taxable Institutional Funds.* We propose to limit a taxable institutional fund to acquiring daily liquid assets unless, immediately after acquiring a security, the fund holds at least 10 percent of its total assets in daily liquid assets.[190] Institutional money market funds typically maintain a greater portion of their assets in cash and overnight repurchase agreements than retail funds, which reflects the greater

---

[181] Proposed rule 2a–7(c)(5)(iii).

[182] A ''demand feature'' means a feature permitting (i) the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the time of exercise, and (ii) the holder of an asset backed security unconditionally to receive principal and interest within 397 calendar days of making demand. Rule 2a–7(a)(8).

[183] U.S. Treasury securities were highly liquid last fall. *See, e.g., FRB Open Market Committee Oct. 28–29 Minutes, supra* note 51, at 5 (''Yields on short-term nominal Treasury coupon securities declined over the intermeeting period, reportedly as a result of substantial flight-to-quality flows and heightened demand for liquidity. In contrast, higher term premiums and expectations of increases in the supply of Treasury securities associated with the Emergency Economic Stabilization Act and other initiatives seemed to put upward pressure on longer term nominal Treasury yields. Yields on longer term inflation-indexed Treasury securities, which are relatively illiquid, rose more sharply than did those on nominal securities.''); *Minutes of the Federal Open Market Committee,* Federal Reserve Board, Dec. 15–16, 2008, at 5, *available at http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20081029.pdf* (''*FRB Open Market Committee Oct. 28–29 Minutes''*) (Dec. 15–16, 2008), at 4, *available at http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20081216.pdf* (''Yields on nominal Treasury coupon securities declined significantly over the intermeeting period in response to safe-haven demands as well as the downward revisions in the economic outlook and the expected policy path. Meanwhile, yields on inflation-indexed Treasury securities declined by smaller amounts, leaving inflation compensation lower. Although the decline in inflation compensation occurred amid sharp decreases in inflation measures and energy prices, it was likely amplified by increased investor preference for the greater liquidity of nominal Treasury securities relative to that of inflation-protected Treasury securities.'').

[184] The term ''daily liquid assets'' is defined in proposed rule 2a–7(a)(8). A ''retail fund'' would be defined as any fund other than an institutional fund. Proposed rule 2a–7(a)(24). For a discussion of the definition of ''institutional fund,'' *see infra* text preceding, accompanying and following note 196. ''Total assets'' means with respect to a money market fund using the amortized cost method, the total amortized cost of its assets and, with respect to any other money market fund, the total market-based value of its assets. Rule 2a–7(a)(27).

[185] *See supra* note 178. On September 17, 2008, approximately 4% of prime retail money market funds and 25% of prime institutional money market funds had outflows greater than 5%; on September 18, 2008, approximately 5% of prime retail funds and 30% of prime institutional funds had outflows greater than 5%; and on September 19, 2008, approximately 5% of prime retail funds and 22% of prime institutional funds had outflows greater than 5%. This information is based on analysis of data from the iMoneyNet Money Fund Analyzer database.

[186] *See* ICI Report, *supra* note 6, at 74.

[187] *See* rule 2a–7(a)(26) (defining ''unconditional demand feature''); rule 2a–7(a)(6) (defining ''conditional demand feature'').

[188] *See* rule 2a–7(d)(3), (5).

[189] This is also the approach rule 2a–7 takes with respect to money market fund credit quality and diversification requirements. *See* rule 2a–7(c)(3), (4).

[190] Proposed rule 2a–7(c)(5)(iii).

liquidity needs of these funds.[191] These greater needs were demonstrated last fall, when (as discussed above) institutional funds were subject to substantially greater redemption pressure than retail funds.[192] We understand that some of these institutional funds had cash positions of almost 50 percent in their portfolios in anticipation of substantial redemptions following the large amount of inflows during 2007 through August 2008.

We request comment on whether institutional money market funds should be subject to a higher daily liquidity requirement (10 percent) than retail funds (five percent). Should we consider a higher percentage, such as 15 or 20 percent? Ten percent daily liquidity could seem high for a money market fund that reserved the right to delay payment of redemptions for seven days. We are not proposing to adjust the appropriate minimum daily liquidity requirement for institutional or retail funds solely by reference to the seven day period, however, because many money market funds undertake to pay redemption proceeds on the same day or the next day, and an announcement by a fund of a delay in payment of redemption could itself precipitate a run on funds. We request comment on whether a five percent daily liquidity requirement for retail funds or a 10 percent daily liquidity requirement for institutional funds should turn on the representations the money market fund has made to its investors regarding the timing of payments of redemption proceeds.

We propose to add two new definitions to rule 2a–7 to distinguish between retail and institutional money market funds. Although the ICI and others who compile data about money market funds have traditionally distinguished between retail and institutional money market funds, in practice the distinctions are not always clear.[193] An institutional fund may have investors who invest on behalf of retail investors. For example, institutional money market funds commonly have investors that are bank sweep accounts or master funds in master-feeder arrangements.[194] Although these investors ordinarily provide cash flows to the fund that are more similar to retail funds, a single decision-maker may be in a position to redeem all of the shares of the money market fund and move the sweep account to another money market fund. In addition, some funds have a single portfolio but issue separate classes of shares to retail and institutional investors that bear different expenses. In these cases, the cost of managing the institutional share class's relatively greater cash flow volatility is shared with the retail investors.

Our proposed amendments would require that a money market fund's board determine, no less frequently than once each calendar year, whether the fund is an institutional money market fund for purposes of meeting the liquidity requirements.[195] In particular, the fund's board of directors would determine whether the money market fund is intended to be offered to institutional investors or has the characteristics of a fund that is intended to be offered to institutional investors, based on the: (i) Nature of the record owners of fund shares; (ii) minimum amount required to be invested to establish an account; and (iii) historical cash flows, resulting or expected cash flows that would result, from purchases and redemptions.[196] The provision is designed to permit fund directors to evaluate the overall characteristics of the fund based on relevant factors.[197] Under the provision, a fund offered through two classes, a majority of whose shares are held by retail investors, should nonetheless be deemed to be an institutional fund by the fund board if the cash flows from purchases and redemptions and the portfolio management required to meet liquidity needs based on those cash flows are more characteristic of an institutional money market fund.

We request comment on our proposed definitions. The differences today in the liquidity management of institutional and retail money market funds suggest to us that fund managers (and perhaps fund boards) currently distinguish between retail and institutional funds. Would our proposed definition permit them to continue to draw the distinctions they draw today? Are there additional factors the board should consider in determining whether a fund is an institutional fund? Would a different approach result in better distinctions? If we cannot distinguish between retail and institutional funds, should we amend rule 2a–7 to apply the minimum daily liquidity requirements we propose for institutional funds to all funds? Would setting the same minimum daily liquidity requirement for institutional and retail funds impose unnecessary costs (in terms of lower yields) on retail investors in light of retail funds' reduced liquidity needs?

Might one effect of the proposed amendments be that funds currently offering two classes of shares, one retail and one institutional, would decide to divide the fund into two funds and manage them differently? Would one of the advantages of such a result be that retail investors would not bear the cost of maintaining liquidity for institutional investors? Would a disadvantage be the loss to retail investors of the economies of scale in these multi-class funds? What additional advantages and disadvantages do commenters foresee? Retail investors may not be aware of the higher redemption rates that institutional funds experienced last fall. Should we consider requiring institutional funds to provide additional disclosures regarding the risk to the fund of large redemptions?

*Tax Exempt Money Market Funds.* We propose to exempt tax exempt funds from the minimum daily liquidity requirements.[198] We understand that most of the portfolios of tax exempt funds consist of longer term floating- and variable-rate securities with seven day demand features from which the fund obtains much of its liquidity. We understand that these funds are unlikely

[191] This information is based on analysis of data from the iMoneyNet Money Fund Analyzer database.

[192] *See supra* note 178.

[193] *See, e.g.,* ICI, Frequently Asked Questions About Money Market Funds, *http://www.ici.org/faqs/faqs_money_funds* (describing (i) institutional money market funds as ''held primarily by businesses, governments, institutional investors, and high-net worth households'' that as of July 2008, held 63 percent of all money market fund assets and (ii) retail money market funds as ''offered primarily to individuals with moderate-sized accounts'' that as of July 2008, held around 37 percent of all money market fund assets); iMoneyNet home page, *http://imoneynet.com/* (separates information and analysis on money market funds into institutional and retail categories); Crane Data, Money Fund Intelligence (June 2009) at 30, *http://www.cranedata.us/products/money-fund-intelligence/* (select issue 2009–06–01 (Vol.4, #6)) (classifying money market funds as institutional or individual based on expense ratio, minimum investment and ''who they're sold to'').

[194] A ''master-feeder fund'' is an arrangement in which one or more funds with identical investment objectives (''feeder funds'') invest all their assets in a single fund (''master fund'') with the same investment objective. Investors purchase securities in the feeder fund, which is an open-end fund and a conduit to the master fund. *See* H.R. Rep. No. 622, 104th Cong., 2d Sess., at 41 (1996) (''H.R. Rep. No. 622''); *see generally* Exemption for Open-End Management Investment Companies Issuing Multiple Classes of Shares; Disclosure by Multiple Class and Master Feeder Funds; Voting on Distribution Plans; Final Rules and Proposed Rule, Investment Company Act Release No. 20915 (Feb. 23, 1995) [60 FR 11876, 11876–77 (Mar. 2, 1995)].

[195] Proposed rule 2a–7(c)(5)(v).

[196] Proposed rule 2a–7(a)(18) (defining ''institutional fund'').

[197] Proposed rule 2a–7(a)(24) would define ''retail fund'' as any money market fund that the board of directors has not determined within the calendar year is an institutional fund.

[198] Proposed rule 2a–7(c)(5). Rule 2a–7 defines a ''tax exempt fund'' as a money market fund that holds itself out as distributing income exempt from regular federal income tax. Rule 2a–7(a)(24).

to have investment alternatives that would permit them to meet a daily liquidity requirement.[199] We request comment on whether tax exempt money market funds could meet a daily liquidity requirement, such as we have proposed for taxable retail funds. Do tax exempt retail money market funds nevertheless have similar liquidity requirements as taxable retail funds? If so, should rule 2a–7 treat them differently and how?

b. Minimum Weekly Liquidity Requirement

We propose that all money market funds (including tax exempt funds) also be subject to a minimum weekly liquidity requirement (''minimum weekly liquidity requirement''). Specifically, retail and institutional funds could not acquire any securities other than U.S. Treasury securities or securities (including repurchase agreements) that mature or are subject to a demand feature exercisable and payable in five business days (together with cash, ''weekly liquid assets'') if, immediately after the acquisition, (i) the retail fund would have invested less than 15 percent of its total assets in weekly liquid assets and (ii) the institutional fund would have invested less than 30 percent of its total assets in weekly liquid assets.[200]

The proposed minimum weekly liquidity requirement would supplement the proposed minimum daily liquidity requirement (discussed above) and give greater assurance that money market funds could meet their statutory obligations to redeem shareholders in times of market turbulence. We estimate that under our proposed minimum weekly liquidity requirement, approximately 93 percent of retail funds and 91 percent of institutional funds would have been able to satisfy the level of redemption demands during the periods of greatest redemption pressure last fall without having to sell portfolio securities.[201]

We request comment on the minimum weekly liquidity requirements. Would a minimum daily liquidity requirement alone be sufficient to allow funds to adequately manage risk in the event of unexpected shareholder redemptions in excess of the daily threshold and market illiquidity? Are the proposed minimums of 15 percent of a retail fund's total assets and 30 percent of an institutional fund's total assets sufficient?[202] Should we, as the ICI Report suggests, adopt the same (20 percent of total assets) test for both retail and institutional funds? As discussed above, we designed our minimum weekly liquidity requirements so that more than 90 percent of retail and institutional funds could have met redemption requests during the week of September 15–19, 2008 without selling portfolio securities. Should we set the threshold lower, such as at 80 percent or 70 percent? Should we set the threshold higher at 95 percent or 100 percent? The weekly liquidity requirement would be essentially the same as the daily liquidity requirement, except that the fund must be able to access cash on a weekly rather than daily basis. Compliance with the test would be determined upon the acquisition of a security, and demand features could be used to determine the maturity of a portfolio security for purposes of the test.

We propose to treat as weekly liquid assets for purposes of the weekly liquidity requirements, the same securities that would be daily liquid assets except that the requirement for maturing securities or demand features would be five business days rather than one.[203] The ICI Report suggests that we ought to treat as a weekly liquid asset a security issued by an agency of the U.S. Government that, when originally issued, had a maturity of 95 days or less.[204] Is there a basis on which to treat these agency securities as weekly liquid assets? If so, why should the maturity of the security be 95 days based on original issue rather than specifying a period remaining to maturity? We urge commenters supporting such treatment to submit market data to support their views.

c. General Liquidity Requirement

As discussed above, the daily and weekly liquidity requirements would be minimum requirements a fund would have to satisfy upon acquisition of a security. A fund's liquidity needs, however, depending upon the volatility of its cash flows, may be greater. Therefore, we also propose to require that a money market fund at all times hold highly liquid securities sufficient to meet reasonably foreseeable redemptions in light of its obligations under section 22(e) of the Act and any commitments the fund has made to shareholders, such as undertaking to pay redemptions more quickly than seven days.[205]

To comply with this condition, we would expect money market funds to consider a number of factors that could affect the fund's liquidity needs. For example, a money market fund would have to understand the characteristics of its investors and their likely liquidity needs. A volatile investor base, *e.g.,* one consisting of a few relatively larger investors that are likely to make significant redemptions, would require a fund to maintain greater liquidity than a stable investor base, which is generally associated with a retail fund with many hundreds or thousands of smaller investors. With this information, a fund manager could take different steps to protect the fund from greater liquidity risk. For example, the fund manager could increase the amount of daily or weekly liquid assets above those required by the daily and weekly requirements, or could decline to accept new investments from investors whose liquidity needs are inconsistent with the objectives of the management of the fund.[206]

We request comment on this proposed requirement for liquidity. Should we consider incorporating specific objective standards for liquidity in this requirement? Should we provide

[199] *See* ICI Report, *supra* note 6, at 74.

[200] Proposed rule 2a–7(c)(5)(iv). The term ''weekly liquid assets'' would be defined in proposed rule 2a–7(a)(32).

[201] During the week of September 15–19, 2008, approximately 6% of retail funds had net redemptions that exceeded 15%, and 9% of institutional money market funds had redemptions that exceeded 30% of assets. In addition, in the 52 weeks preceding September 17, 2008, roughly the same portion of redemption requests in institutional and retail funds (less than 2%) would have exceeded the weekly liquidity requirements. This information is based on analysis of data from iMoneyNet Money Fund Analyzer database.

[202] We note that for most weeks during the past year, prime institutional money market funds maintained over 30% of their assets in securities maturing in seven days or less. This information is based on analysis of data from iMoneyNet Money Fund Analyzer database.

[203] *Compare* proposed rule 2a–7(a)(8) with proposed rule 2a–7(a)(32).

[204] *See* ICI Report, *supra* note 6, at 74.

[205] Proposed rule 2a–7(c)(5)(ii). Our proposal is similar to the liquidity standard we proposed last year in the proposal on NRSRO references. *See* NRSRO References Proposal, *supra* note 105, at Section III.A.2. Among the commenters that specifically addressed that proposed standard, two suggested that codification of the standard was not needed because money market fund advisers already understand and adhere to the current standards. *See* Comment Letter of Fidelity Management & Research Company (Aug. 29, 2008) (File No. S7–19–2008); Comment Letter of the Securities Industry and Financial Markets Association Credit Rating Agency Task Force (Sept. 4, 2008) (File No. S7–19–2008). A third suggested eliminating the standard because it involves ''subjective, forward-looking estimates,'' while retaining a proposed maximum level for illiquid securities holdings to ''preserve a clearer bright-line test''). *See* Comment Letter of Morrison & Foerster (Sept. 5, 2008) (File No. S7–19–2008).

[206] We do not mean to suggest that each money market fund should minimize the volatility of cash flows, but rather should limit its liquidity risks. Some money market funds with the most volatile shareholder base manage liquidity risk by, for example, investing exclusively in overnight repurchase agreements or Treasury debt.

guidance regarding the steps fund advisers could take to evaluate the fund's liquidity needs? If so, what should the guidance be?

Because the obligation would be ongoing, we believe a fund should adopt policies and procedures to assure that appropriate efforts are undertaken to identify risk characteristics of shareholders, particularly those that hold their securities through omnibus accounts, or access the fund through ''portals'' or through other arrangements that provide the fund with little or no transparency with respect to the beneficial shareholder. We are not proposing to amend rule 2a–7 to require that funds adopt specific procedures because we believe those procedures would be required by rule 38a–1, the ''compliance rule'' under the Investment Company Act, if we adopt the proposed general liquidity requirement.[207] Should the Commission provide guidance to funds to assist them in determining the adequacy of their policies and procedures? Should we consider specifying any particular aspects of the policies and procedures?

In their consideration of these procedures and in their oversight of their implementation, fund directors should understand that fund managers' interest in increasing fund assets, and thus their advisory fees, may lead them to accept investors who present greater risks to the fund than they might otherwise have accepted. We urge directors to consider the need for establishing guidelines for advisers to money market funds that address this potential conflict. We are aware of more than one occasion in which a fund adviser (or its affiliate that served as the principal underwriter to the fund) has marketed the fund to ''hot money'' in order to increase fund assets, which has exposed the fund to substantially higher risks.

3. Stress Testing

We are also proposing to amend rule 2a–7 to require the board of directors of each money market fund using the amortized cost method to adopt procedures providing for periodic stress testing of the money market fund's portfolio.[208] The procedures would require testing of the fund's ability to maintain a stable net asset value per share based upon certain hypothetical events, including an increase in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on a portfolio security, and 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 the fund.

Our proposal would require funds to test for certain hypothetical events, but would not specify other details of the stress testing. The proposal would require that stress tests be conducted at intervals that the board of directors determines appropriate and reasonable in light of current market conditions. This is the same approach that rule 2a–7 currently takes with respect to the frequency of shadow pricing.[209]

The proposed amendments also would leave to the money market fund's board of directors (and the fund manager) the specifics of the scenarios or assumptions on which the tests are based. Boards should, for example, consider procedures that require the fund to test for the concurrence of multiple hypothetical events, *e.g.,* where there is a simultaneous increase in interest rates and substantial redemptions. The proposed amendments also would require that the board receive a report of the results of the testing at its next regularly scheduled meeting, which report must include: (i) The date(s) on which the fund portfolio was tested; and (ii) the magnitude of each hypothetical event that would cause the money market fund to break the buck.[210] Thus, a fund must test each hypothetical event to a degree of severity that it would result in the market-based per share net asset value of the fund to fall below $0.995 (in the case of a fund that is maintaining a stable net asset value at $1.00). The proposed amendment also would require the written procedures to include the provision of an assessment by the 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.[211] The adviser's assessment would provide the fund board context within which to evaluate the magnitude of the events that would cause the fund to break the buck. Finally, funds would be required to maintain records of the stress testing for six years, the first two years in an easily accessible place.[212]

We believe that the proposed stress testing procedures would provide money market fund boards a better understanding of the risks to which the fund is exposed and would give managers a tool to better manage those risks. We understand that stress testing is already a best practice followed by many money market funds. The ICI Report recommends that rule 2a–7 require money market funds regularly to ''stress test'' their portfolios, although it does not suggest a particular means of stress testing.[213] The Institutional Money Market Funds Association provides guidance for its members in stress testing money market fund portfolios,[214] and the ratings agencies stress test the portfolios of money market funds they rate.[215]

We request comment on our proposed stress test requirement. Would this requirement allow fund managers to better understand and manage the risks to which the fund is exposed? Have we identified the correct stress events? If not, what additional or alternative scenarios or assumptions should we require the fund to test? Should we specify at least one base-line stress test that would test the fund portfolio against a combination of two or more events? For example, the rule could require that the market value per share of the fund be tested against an assumed 50 basis point increase in LIBOR and a redemption of 15 percent of fund shares. Are there alternative base-line tests we should consider requiring?

We request comment on our proposal to require that the board receive a report on these tests. Would the report help the board identify when a fund adviser is exposing the fund to greater risks? Should the board only receive a report when the tests indicate a particular level of risk? If so, what particular level of risk should the rule identify? Should we consider including additional information in the report, and if so, what should it be? Should the rule provide for a minimum frequency of testing? If so, what should be the frequency (*e.g.,* monthly, weekly, or a shorter period)? Should we consider

[207] *See* rule 38a–1(a)(1) (requiring funds to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws by the fund).

[208] Proposed rule 2a–7(c)(8)(ii)(D)(*1*).

[209] Rule 2a–7(c)(7)(ii)(A)(*1*).

[210] Proposed rule 2a–7(c)(8)(ii)(D)(*2*).

[211] Proposed rule 2a–7(c)(8)(ii)(D)(*3*).

[212] Proposed rule 2a–7(c)(11)(vii).

[213] ICI Report, *supra* note 6, at 75.

[214] *See* Institutional Money Market Funds Association, Stress Testing for Money Market Funds (Feb. 2009).

[215] *See, e.g.,* Standard & Poor's, Fund Ratings Criteria, at 9 (2007), *available at http://www2.standardandpoors.com/spf/pdf/events/FundRatingsCriteria.pdf. See also* Financial Regulator Guidance Note 1/08, *supra* note 146, at 5 (requirements of the Irish Financial Services Authority for money market funds domiciled in Ireland include stress testing: ''A money market fund is expected to be subject to monthly portfolio analysis incorporating stress testing to examine portfolio returns under various market scenarios to determine if the portfolio constituents are appropriate to meet pre-determined levels of credit risk, interest rate risk, market risk and investor redemptions.'').

different intervals for different types of money market funds? If so, what intervals would be appropriate for what types of money market funds? Should the frequency depend upon the market-based value of the fund portfolio or other criteria or events?

We note that certain of the hypothetical events we propose funds include in their testing may not be meaningful for some money market funds. For example, U.S. Treasury money market funds (*i.e.,* funds that invest solely in direct obligations of the U.S. government such as U.S. Treasury bills and other short term securities backed by the full faith and credit of the U.S. government) are not likely to experience downgrades of or defaults on those securities. Should these money market funds be exempted from testing certain hypothetical events, such as a downgrade of or default on a portfolio security, that may not present risks to the fund? Are there other money market funds that we should exempt from testing for certain of the proposed hypothetical events? If so, which funds should have exemptions and which events should be exempted from their testing?

The ICI Report suggests that the results of stress testing could be used to evaluate whether a money market fund's liquidity thresholds need to be adjusted.[216] Should we consider imposing minimum liquidity requirements based on the results of a particular stress test? For example, should we require that a fund invest 50 percent of its portfolio in daily or weekly liquid assets if a five percent increase in shareholder redemptions would cause the fund to break the buck? If we considered imposing minimum liquidity requirements, should they be different for retail and institutional funds?

*D. Diversification*

Rule 2a–7 requires a money market fund's portfolio to be diversified, both as to the issuers of the securities it acquires and to the guarantors of those securities.[217] Generally, money market funds must limit their investments in the securities of any one issuer (other than Government securities), to no more than five percent of fund assets.[218] They must also generally limit their investments in securities subject to a demand feature or a guarantee to no more than ten percent of fund assets from any one provider.[219] The Commission adopted these requirements in order to limit the exposure of a money market fund to any one issuer or guarantor.[220]

The issuer diversification provisions of the rule generally were not implicated by the market turbulence last fall.[221] The Reserve Primary Fund, for example, held only 1.2 percent of its assets in Lehman Brothers commercial paper, well below what rule 2a–7 permits. The market turbulence did, however, implicate the guarantor and demand feature diversification provisions—many funds (particularly tax exempt funds) were heavily exposed to bond insurers, and some were heavily exposed to a few major securities firms that served as liquidity providers.[222]

Should we propose to further restrict the diversification limits of the rule? If so, by how much should we reduce them? Should the five percent diversification limit for issuers be reduced to, for example, three percent? Would it be possible to further reduce the guarantor diversification limits without reducing the quality of portfolio securities? Even a diversification limitation of one percent would not preclude a fund from breaking a buck if the security should sustain sufficient losses as did the securities issued by Lehman Brothers. Moreover, such a diversification limit may force funds to invest in relatively lower quality securities. If so, might lower diversification limits increase the likelihood of a default or other credit event affecting a money market fund while diminishing the impact of such an event on the fund? We request that commenters address the tradeoffs of lower diversification limits for different types of money market funds.

Last fall, money market funds did appear to be extensively exposed to securities issued by participants in the financial sector, which contributed significantly to the difficulties they experienced.[223] Money market funds are not subject to any industry concentration limitations under rule 2a–7. Should we consider proposing such a limitation? If we did, what should the concentration limit be? Are distinctions among industry sectors sufficiently clear that a concentration limitation would be meaningful?[224]

*E. Repurchase Agreements*

Money market funds typically invest a significant portion of their assets in repurchase agreements, many of which mature the following day and provide an immediate source of liquidity.[225] In a typical repurchase agreement, a fund purchases securities from a broker-dealer or a bank (''counterparty''), upon an agreement that the counterparty will repurchase the same securities at a specified price, at a later date. The securities purchased serve as the collateral for the agreement.

Money market funds may treat the acquisition of a repurchase agreement as an acquisition of the collateral underlying the repurchase agreement for purposes of meeting rule 2a–7's diversification requirement, provided that the repurchase agreement is ''collateralized fully.''[226] A repurchase

[216] *See* ICI Report, *supra* note 6, at 75.

[217] Rule 2a–7(c)(4)(i). The diversification requirements of rule 2a–7 differ in significant respects from the requirements for diversified management investment companies under section 5(b)(1) of the Act. A money market fund that satisfies the applicable diversification requirements of the paragraphs (c)(4) and (c)(5) of the rule is deemed to have satisfied the requirements of section 5(b)(1). Rule 2a–7(c)(4)(v). Subchapter M of the Internal Revenue Code contains other diversification requirements for a money market fund to be a ''regulated investment company'' for federal income tax purposes. 26 U.S.C. 851 *et seq. See also* 1990 Proposing Release, *supra* note 22, at n.25.

[218] Rule 2a–7(c)(4)(i)(A). The rule contains a safe harbor where a taxable and national tax exempt fund may invest up to 25 percent of its assets in the first tier securities of a single issuer for a period of up to three business days after acquisition (but a fund may use this exception for only one issuer at a time). Rule 2a–7(c)(4)(i)(A).

[219] Rule 2a–7(c)(4)(iii). With respect to 25 percent of total assets, holdings of a demand feature or guarantee provider may exceed the 10 percent limit subject to certain conditions. See rule 2a–7(c)(4)(iii)(A), (B), and (C). *See also* rule 2a–7(a)(8) (definition of ''demand feature'') and (a)(15) (definition of ''guarantee'').

[220] *See* 1990 Proposing Release, *supra* note 22, at II.1. (''Diversification limits investment risk to a fund by spreading the risk of loss among a number of securities.'').

[221] The positions held by funds in distressed securities were in almost all cases well below the rule's diversification limits.

[222] *See, e.g.,* Brunnermeier, *supra note 66,* at 87.

[223] *See, e.g.,* U.S. Dollar Money Market Funds, *supra* note 17, at 67 (mid-2008 holdings of 15 largest prime money market funds showed they had invested $1 trillion, or half of their portfolios, with non-U.S. banks).

[224] In 1992, our staff observed that ''the current [statutory] treatment of 'concentration' suffers from problems of industry definition. There is no clear standard to determine what constitutes an 'industry,' much less 'a group of industries.' Indeed, as the boundaries between different industries erode and the trend toward corporate diversification and conglomeration continues, it is often difficult to fit companies into distinct industry categories * * *.'' Division of Investment Management, U.S. Securities and Exchange Commission, Protecting Investors: A Half Century of Investment Company Regulation, at n.103 (May 1992).

[225] In 2008, repurchase agreements accounted for 26.4% of taxable Government money market funds' total net assets and 9.1% of taxable non-Government money market funds' total net assets. *See* 2009 Fact Book, *supra* note 7, at 150–51, Tables 41 & 42.

[226] *See* rule 2a–7(c)(4)(ii)(A). We have allowed this ''look-through'' treatment, for diversification purposes, based on the notion that a money market fund looks to the collateral rather than the counterparty as the ultimate source of repayment. *See* Treatment of Repurchase Agreements and Refunded Securities as an Acquisition of the Underlying Securities, Investment Company Act

agreement collateralized fully must, among other things, qualify for an exclusion from any automatic stay of creditors' rights against the counterparty under applicable insolvency law.[227] We propose two amendments to rule 2a–7 affecting a money market fund's investment in repurchase agreements.

First, we propose to limit money market funds to investing in repurchase agreements collateralized by cash items or Government securities in order to obtain special treatment under the diversification provisions of rule 2a–7.[228] Such a limitation would make it less likely that, in the event of the default of a counterparty during a period of market turmoil such as last fall, a money market fund would experience losses upon the sale of collateral that had become illiquid. Such a consequence is more likely in the case of a default by a large counterparty when, as a result, many investors in repurchase agreements seek to liquidate similar collateral at the same time.[229]

We request comment on this amendment. We understand that most money market funds that take advantage of the diversification ''look-through'' provision enter into repurchase agreements that are collateralized by Government securities. Is our understanding correct? If so, would this amendment have a significant impact on money market funds? Would the amendment significantly reduce the risk of losses upon the default of a repurchase agreement counterparty? Would it negatively impact money market funds' yields? Should we apply this limitation to repurchase agreements that are not collateralized fully, and thus do not qualify for the special ''look-through'' treatment?

Second, we propose to require that the money market fund's board of directors or its delegate evaluate the creditworthiness of the counterparty, regardless of whether the repurchase agreement is collateralized fully.[230] We eliminated this requirement in 2001 in light of amendments to relevant bankruptcy law that protected funds from the automatic stay of creditors' rights under applicable bankruptcy law.[231] The events of last fall, which involved the failure of a large investment bank holding company that served as a counterparty, suggest we should revisit this determination.[232] We are concerned that in the midst of a crisis following the bankruptcy of a counterparty, a money market fund may find it difficult to protect fully its interests in the collateral without incurring losses.[233] A fund should seek to avoid such a crisis by limiting its counterparties to those that are creditworthy. We request comment on this proposed amendment.

*F. Disclosure of Portfolio Information*

1. Public Website Posting

The Commission is proposing to amend rule 2a–7 to require money market funds to disclose information about their portfolio holdings each month on their websites. Specifically, a fund would be required to disclose the fund's schedule of investments, as prescribed by rules 12–12 to 12–14 of Regulation S–X,[234] identifying, among other things, the issuer, the title of the issue, the principal amount of the security, and its current amortized cost.[235] The fund would be required to post the information no later than the second business day of the month, current as of the last business day of the previous month, and would have to maintain the information on the website for at least twelve months.[236]

Currently, money market funds must report portfolio holdings information to us four times a year, no earlier than within 60 days of the close of the covered period.[237] Many funds today provide this information to their investors much more frequently on their websites, with some funds updating information each day.[238]

We understand that the greater transparency provided by many funds today responds to demands from investors, particularly institutional investors, who wish to have a better understanding of the current risks to which the fund is exposed.[239] Those investors find that the quarterly reports are too infrequent in light of the rapid turnover of money market fund portfolios. We believe that the greater transparency of fund portfolios is a positive development by which investors can exert influence on risk-taking by fund advisers, and thus reduce the likelihood that a fund will break the buck.

We request comment on the proposed monthly portfolio disclosure requirement. Should we require more information from funds than what we have proposed? If so, what additional information should we require? Should

---

Release No. 25058 (July 5, 2001) [66 FR 36156 (July 11, 2001)] (''2001 Repo Rule Adopting Release''), at Background. Rule 5b–3 allows the same treatment for purposes of section 5 and section 12(d)(3) of the Act. The rule 5b–3(c)(1) definition of collateralized fully, which is cross-referenced by rule 2a–7(a)(5), sets forth the related conditions. Money market funds may enter into repurchase agreements that are not collateralized fully. Any agreement or portion of agreement that is not collateralized fully would be deemed an unsecured loan. As such the loan itself would have to meet the quality requirements set forth in rule 2a–7, both with respect to the minimal credit risk and the high quality rating, as well as the five percent diversification test. *See* 1991 Adopting Release, *supra* note 20, at n.31.

[227] *See* rule 5b–3(c)(1)(v).

[228] Proposed rule 2a–7(a)(5). Under the current definition of collateralized fully, a money market fund may look through repurchase agreements collateralized with cash items, Government securities, securities with the highest rating or unrated securities of comparable credit quality. Rule 5b–3(c)(1)(iv). Repurchase agreements have traditionally been collateralized with U.S. Treasury and agency securities, but over the years borrowers have increasingly used investment grade corporate bonds, mortgage-backed securities and other potentially illiquid securities. *See* Martin Duffy et al., *supra* note 191, at 3. Our staff's examination of the portfolio holdings in the 15 largest money market fund complexes last spring indicated that approximately 75% of the collateral supporting repurchase agreements held by the funds consisted of Government securities (48.3% agencies and 26.4% U.S. Treasuries). The exam further indicated that the remaining collateral consisted of a variety of instruments, such as equities, commercial paper, corporate notes, and mortgage loan obligations.

[229] If the counterparty defaults, a money market fund might be required to dispose of the collateral as soon as possible to the extent that the collateral, now part of the fund's portfolio, does not meet the fund's maturity or liquidity requirements. Such requirements do not apply to the collateral when it is not part of the fund's portfolio. *See* 1991 Adopting Release, *supra* note 20, at n.33 and accompanying text.

[230] Proposed rule 2a–7(c)(4)(ii)(A). It appears that this evaluation is already being made in many fund complexes. *See* ICI Report, *supra* note 6, at n.90.

[231] *See* 2001 Repo Rule Adopting Release, *supra* note 226, at nn.18–20 and accompanying text.

[232] We understand that a number of money market funds discontinued entering into repurchase agreements with The Bear Stearns Companies Inc. (''Bear Stearns'') when it was threatened with collapse in March 2008. ICI Report, *supra* note 6, at 51.

[233] *See* Stephen Morris & Hyun Song Shin, *Financial Regulation in a System Context,* Brookings Papers on Economic Activity, Fall 2008, at 229, 239 (noting that ''if Bear Stearns had become illiquid, and the assets pledged as collateral reverted to the money market funds, they would have been forced to sell those assets quickly, possibly at a large loss.''). *Cf. Calyon N.Y. Branch* v. *Am. Home Mortg. Corp. (In re Am. Home Mortg., Inc.),* 379 B.R. 503, 520–22 (Bankr. D. Del. 2008) (Holding that seller in bankruptcy was not required to transfer to the buyer the right to service the collateral of the repurchase agreement. The court found that the servicing provisions of the agreement were severable from the repurchase provisions, dismissing the buyer's argument that without the servicing rights the buyer's ability to liquidate the collateral would have been impaired.).

[234] 17 CFR 210.12–12 to 12–14.

[235] Proposed rule 2a–7(c)(12).

[236] *Id.*

[237] Money market funds must provide a full schedule of their portfolio holdings in quarterly filings to the Commission. *See* Form N–CSR [17 CFR 274.128] (form used by registered management investment companies to file shareholder reports); Form N–Q [17 CFR 274.130] (form used by registered management investment companies to file quarterly reports of portfolio holdings after the first and third quarters).

[238] *See* Colleen Sullivan & Mike Schnitzel, *Money Funds Move to Update Holdings Faster,* Fund Action, Sept. 29, 2008, *available at http://www.fundaction.com/pdf/FA092908.pdf.*

[239] *See id.*

we require that money market funds also post their market-based net asset value per share and the market-based prices of their portfolio securities? This information would enable investors to understand the fund's exposure to distressed securities (the market value of which would be less than the amortized cost). In addition, it could help investors understand the risk that the fund may be unable to maintain a $1.00 stable net asset value. Currently, only larger, more sophisticated investors may be able to gauge this risk, by themselves estimating the market value of portfolio securities disclosed on fund websites. Thus, a requirement that funds disclose the market-based values may help to level the playing field for all investors. On the other hand, we acknowledge that disclosure of shadow pricing could cause certain investors to redeem their holdings once the shadow price drops below a certain threshold and thus potentially introduce greater instability.

We request comment on how investors might react to the disclosure of market-based values and the consequences to funds and shareholders if such information were disclosed. Would investors seek to redeem their shares when the fund's market-based net asset value falls below a certain threshold because of concerns that other investors may seek to redeem? Would market analysts follow and report this information and thereby cause investors to redeem if the fund's market-based net asset value falls below a certain threshold? Would the disclosure of market-based values, in addition to amortized cost, confuse investors, particularly retail investors? Are there costs to disclosing this information, and, if so, what are they? Alternatively, would this information provide shareholders with useful information regarding the fund's risk characteristics? Would it enable investors to make better informed investment decisions? Would this information benefit investors, and, if so, how? If the market-based values were required to be disclosed, how frequently should they be disclosed? Would monthly disclosure be frequent enough for investors to understand how often and to what extent a money market fund's market-based share price deviates from the $1.00 stable share price?

Should we omit any of the proposed disclosure requirements? If so, what information should be omitted from the proposed requirement, and why?

Each money market fund would have to update its portfolio schedule as of the end of each month and post the update no later than two business days after the end of the month. Should we provide for a longer delay to prevent cash investors other than shareholders from trading along with the fund, to the possible detriment of the fund and its shareholders? The ICI Report recommended monthly disclosure with a two-day delay, asserting that ''front running'' concerns are less of a risk for money market funds than other types of mutual funds.[240] We understand that funds that already post portfolio schedules frequently have come to the same conclusion. Should funds be required to provide more frequent disclosure of portfolio holdings (*e.g.,* weekly or biweekly)?

The amendments would require that a fund post the information on its website for at least 12 months. Should the information be accessible on the website for a longer or shorter time period? Should we require this information somewhere other than on the fund's website? Do all money market funds have websites?

2. Reporting to the Commission

We are also proposing a new rule requiring money market funds to provide the Commission a monthly electronic filing of more detailed portfolio holdings information.[241] The information would enable the Commission to create a central database of money market fund portfolio holdings, which could enhance our oversight of money market funds and our ability to respond to market events.[242]

Our current information on money market fund portfolios is limited to quarterly reports filed with us which, as noted above, quickly become stale. Moreover, the reports are not filed in a format that allows us to search expeditiously across portfolios or within a portfolio to identify securities that may raise concerns. In 2007, our staff was not able to ascertain quickly which money market funds held SIVs, and last fall we had to engage in lengthy and time-consuming inquiries to determine which money market funds held commercial paper issued by Lehman Brothers after it declared bankruptcy. Further, if we had had such data immediately available to us, we could have provided additional assistance to the Treasury Department or the Federal Reserve Board in structuring the programs they put into place to protect investors.[243] In preparing this release we have relied in part on data about money market funds available only through industry associations and publications.[244]

Proposed rule 30b1–6 would provide us information that would assist our staff in analyzing the portfolio holdings of money market funds, and thus enhance our understanding of the risk characteristics of individual money market funds and money market funds as a group and industry trends. We would be able to identify quickly those funds that are holding certain types of securities or specific securities, such as distressed securities, and funds that have unusual portfolios that may involve greater risks than are typical (*e.g.,* funds that have higher gross yields).

Although the portfolio reports to the Commission are not primarily designed for individual investors, we would expect to make the information available to the public two weeks after their filing. We anticipate that academic researchers, financial analysts and economic research firms would use this information to study money market fund holdings and evaluate their risk information. Their analyses may further help investors and regulators better understand risks in money market funds. In addition, we believe that delaying the public availability of this information would alleviate possible concerns about the public disclosure of the detailed portfolio holdings information contained in the filing, without compromising its utility.[245]

Proposed rule 30b1–6 would require money market funds to file a monthly portfolio holdings report on new Form

[240] *See* ICI Report, *supra* note 6, at 93.

[241] Proposed rule 30b1–6.

[242] In 1995, the Commission proposed, but did not adopt, a similar rule that would have required money market funds to file quarterly reports of portfolio holdings. Money Market Fund Quarterly Reporting, Investment Company Act Release No. 21217 (July 19, 1995) [60 FR 38467 (July 26, 1995)]. *See also* Rulemaking Petition from Fund Democracy, *et al.* (Jan. 16, 2008) (File No. 4–554) (recommending that the Commission require money market funds to make nonpublic monthly electronic filings of their portfolio holdings).

[243] The Treasury's Guarantee Program requires a participating money market fund to provide a schedule of its portfolio holdings if its market-based net asset value falls below 99.75 percent of its stable net asset value. *See* U.S. Department of the Treasury, ''Guarantee Agreement (Stable Value),'' ¶ 5(b), *available at http://www.treas.gov/offices/domestic-finance/key-initiatives/money-market-docs/Guarantee_Agreement_Stable-Value.pdf.*

[244] *See, e.g., supra* note 68.

[245] As discussed above, we understand the confidentiality of certain portfolio holdings information is not of critical importance to money market funds. Accordingly, the proposed amendments to rule 2a–7 would require money market funds to disclose certain monthly portfolio holdings information on their websites within two days after the end of month. *See also* ICI Report, *supra* note 6, at 93 (recommending that funds disclose monthly portfolio holdings information after a two-day delay). Here, however, the more detailed information included in the filing to the Commission may present more significant concerns.

N–MFP (for ''money fund portfolio'' reporting) no later than the second business day of each month, current as of the last business day of the previous month.[246] Proposed Form N–MFP would require the fund to report, with respect to each portfolio security held on the last business day of the prior month, among other things: (i) The name and CIK number of the issuer; (ii) the title of the issue; (iii) the CUSIP number or other unique identifier; (iv) the category of investment (*e.g.,* Treasury debt, government agency debt, corporate commercial paper, structured investment vehicle notes, etc.); (v) the current credit ratings of the issuer and the requisite NRSROs giving the ratings; (vi) the maturity date as determined under rule 2a–7; (vii) the final legal maturity date; (viii) whether the maturity date is extendable; (ix) whether the instrument has certain enhancement features; (x) the identity of any enhancement provider; (xi) the current credit rating of the enhancement provider; (xii) the principal amount; (xiii) the current amortized cost value; (xiv) certain valuation information (*i.e.,* whether the inputs used in determining the value of the securities are Level 1, Level 2 or Level 3,[247] if applicable); and (xv) the percentage of the money market fund's assets invested in the security.[248] In addition, Form N–MFP would require funds to report to us information about the fund's risk characteristics, such as the fund's dollar weighted average maturity of its portfolio and its 7-day gross yield.

Given the rapidly changing composition of money market fund portfolios, which is largely the result of securities maturing, we believe that monthly reports would improve the timeliness and relevance of portfolio information. Once a money market fund has established a system for tagging and filing a Form N–MFP, we expect the marginal costs of filing additional reports would be minimal.[249]

Under the proposed rule, Form N–MFP would be filed electronically through the Commission's EDGAR system in an eXtensible Markup Language (''XML'') tagged data format.[250] We understand that money market funds already maintain the requested information, and therefore would need only to tag the data and file the reports with the Commission.[251] We anticipate that, in the future, many funds may be able to collect, tag, and file this information with the Commission through even more efficient, automated processes, thereby minimizing the related costs and potential for clerical error.

We request comment on the proposed monthly portfolio reporting requirement. Should we require funds to file the portfolio holdings report on a more frequent basis? As discussed above, we intend to make this information publicly available two weeks after the report is filed with the Commission. Would such a delay alleviate concerns about possible front-running or other possible harms that might be caused by making the information public? Should the lag time between the filing of the form and its public availability be longer or shorter? Should the information be immediately available to the public upon filing? Should we instead provide that all or a portion of the requested information be submitted in nonpublic reports to the Commission? If so, please identify the specific items that should remain nonpublic and explain why.

Proposed Form N–MFP requires money market funds to disclose certain items that would be relevant to an evaluation of the risk characteristics of the fund and its portfolio holdings. Should we require additional or alternative information, such as the fund's client concentration levels, the percentage of the issue held by the fund, or last trade price and trade volume for each security?[252] Should we require funds to disclose market-based values (including the value of any credit support agreement), which would allow us to identify funds that have market-based net asset values that sufficiently deviate from their amortized cost that they present a risk of breaking the buck? Would the two-week delay in making the information publicly available mitigate any concerns about the disclosure of this information? Alternatively, should we require funds to provide the market-based values information to us on a nonpublic basis?[253] If funds were required to provide market-based values information to us on a nonpublic basis, should we require funds to provide this information more frequently once the fund's net asset value per share falls below a certain threshold? If so, how frequently should funds be required to provide this information (*e.g.,* weekly or daily) and what should be the threshold (*e.g.,* $0.9975)?

Should we omit any proposed disclosure requirement? Are there specific items that the proposed form would require that are unnecessary or otherwise should not be required?

We request comment on feasible alternatives that would minimize the reporting burdens on money market funds.[254] We also request comment on the utility of the reports to the Commission in relation to the costs to money market funds of providing the reports.[255] In addition, we request comment on whether funds should be permitted to post a human readable version of their Forms N–MFP on their Web sites to satisfy the proposed monthly Web site disclosure requirement.

The Commission anticipates that the data to be required by proposed Form N–MFP would be clearly defined and often repetitive from one month to the next. Therefore, we believe the XML format would provide us with the necessary information in the most timely and cost-effective manner. Should the Commission allow or require the form to be provided in a format other than XML, such as eXtensible Business Reporting Language (''XBRL'')? Is there another format that is more widely used or would be more

[246] The portfolio securities information that money market funds currently must report is more limited in scope, and includes information about the issuer, the title of the issue, the balance held at the close of the period, and the value of each item at the close of the period. *See* Form N–Q, Item 1 [17 CFR 274.130]; Rules 12–12 to 12–14 of Regulation S–X [17 CFR 210.12–12 to 12.14].

[247] *See* Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 157, ''Fair Value Measurement,'' available at http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175818754924&blobheader=application%2Fpdf.*

[248] In addition, proposed Form N–MFP would include an ''Explanatory Notes'' item to permit funds to add miscellaneous information that may be material to other disclosure in the form.

[249] *See also infra* Section V.

[250] We anticipate that the XML interactive data file would be compatible with a wide range of open source and proprietary information management software applications. Continued advances in interactive data software, search engines, and other web-based tools may further enhance the accessibility and usability of the data.

[251] We understand that many funds often provide this type of information in different formats to various information services and third-parties, including NRSROs. Standardizing the data format in proposed Form N–MFP may encourage standardization across the industry, resulting in cost savings for money market funds.

[252] *See* Rulemaking Petition from Fund Democracy, *supra* note 242 (recommending that the Commission require money market funds to disclose to the Commission, among other things, the percentage of an issue owned by a fund and its affiliates and the last trade price and trade volume for each portfolio security).

[253] *See supra* discussion at paragraph following note 239 and paragraph preceding note 240.

[254] *See* section 30(c)(2)(A) of the Investment Company Act (requiring Commission to consider and seek public comment on feasible alternatives to the required filing of information that minimize reporting burdens on funds).

[255] *See* section 30(c)(2)(B) of the Investment Company Act (requiring Commission to consider and seek public comment on the utility of information, documents and reports to the Commission in relation to the associated costs).

appropriate for the required data? Is there a need for more detailed categories of data? What would be the costs to funds of providing data in the XML format? Would there be a disproportionate cost burden on smaller fund companies? Is there another format that would be less costly but still allow investors and analysts easily to view (or download) and analyze the data from a central database? Should the Commission use the EDGAR database or should it create a new database? Should the Commission consider the implementation of reporting on Form N–MFP initially through a voluntary pilot program?

3. Amendment to Rule 30b1–5

To avoid unnecessarily duplicative disclosure obligations, we propose to amend rule 30b1–5 to exempt money market funds from the requirement to file their schedules of investments pursuant to Item 1 of Form N–Q, a quarterly schedule of portfolio holdings of management investment companies.[256] We request comment on this exemption. We are not proposing to exempt money market funds from the controls and procedures and certification requirements of Form N–Q. Should we also exempt money market funds from Item 2 of Form N–Q, which requires disclosure of certain information about a fund's controls and procedures, and/or Item 3 of Form N–Q, which requires certain fund officers to file a certification as an exhibit to the form? [257] Should we exempt money market funds from the portions of Items 2 and 3 that pertain to the schedule of investments required by Form N–Q? Alternatively, should we amend Form N–Q and/or rule 30b1–5 to apply similar controls and procedures and certification requirements to the proposed monthly reporting requirement? Should we exempt money market funds from requirements to provide portfolio schedules in Form N–CSR? [258]

### *G. Processing of Transactions*

We are proposing to require that each money market fund's board determine in good faith, at least once each calendar year, that the fund (or its transfer agent) has the capacity to redeem and sell its securities at a price based on the current net asset value per share.[259] This proposed amendment would require money funds to have the operational capacity to ''break a dollar'' and continue to process investor transactions in an orderly manner.[260]

Money market funds that seek to maintain a stable net asset value do not guarantee that they will be able to maintain the stable net asset value. Indeed, each money market fund prospectus must disclose that an investor may lose money by investing in the fund.[261] Nonetheless, we understand that some money market funds do not have in place systems to process purchases and redemptions at prices other than the funds' stable net asset value. In other words, the systems of these money market funds and their transfer agents are ''hardwired'' to process shareholder transactions at only the stable net asset value.

The consequences of such an operational limitation contributed to the delays in redeeming shareholders of The Reserve Primary Fund after that fund broke the buck in September 2008. We understand that all transactions thereafter had to be processed manually, a time-consuming and expensive process that extended the time that shareholders had to wait for the proceeds from their shares.[262]

We believe that money market funds that do not have the operational capacity to price shares according to market values expose their shareholders to unnecessary risks—risks that may render a money market fund unable to meet its obligations under section 22(e) of the Act to pay the proceeds of a redemption within seven days. Therefore, we propose to amend rule 2a–7 to require that a money market fund's board determine in good faith, no less frequently than once each calendar year, that the fund (or its transfer agent) has the capacity to redeem and sell fund shares at prices based on the current net asset value per share. The proposed amendment also clarifies that this capacity includes the capacity to sell and redeem shares at prices that do not correspond to the stable net asset value or price per share.[263]

We request comment on this proposed amendment. Is it appropriate? Should the board play a role in this determination? Should we instead revise the risk-limiting conditions of the rule to require that the fund simply have the capacity to redeem and sell securities at market-based prices? Alternatively, should the rule require that the board determine that the fund has adopted procedures adequate to enable the fund to redeem and sell securities at market-based prices? Or should the rule require that the board approve such procedures? If the rule requires a determination by the board, is an annual determination appropriate? Should the determination be more frequent (*e.g.,* quarterly) or less frequent (*e.g.,* every three years)?

### *H. Exemption for Affiliate Purchases*

The Commission is proposing to amend rule 17a–9, which provides an exemption from section 17(a) of the Act to permit affiliated persons of a money market fund to purchase distressed portfolio securities from the fund.[264] The amendment would expand the circumstances under which affiliated persons can purchase money market

[256] Item 1 of Form N–Q requires funds to file the schedule of investments, as of the close of the reporting period, in accordance with rules 12–12—12–14 of Regulation S–X.

[257] 17 CFR 274.130.

[258] *See supra* note 237.

[259] Proposed rule 2a–7(c)(1) (new last two sentences).

[260] Once a fund has broken the buck, the fund could no longer use the amortized cost method of valuing portfolio securities, and therefore would have to compute share price by reference to the market values of the portfolio with the accuracy of at least a tenth of a cent. *See* 1983 Adopting Release, *supra* note 3, at n.6 and accompanying text. Thus, a fund whose market-based net asset value was determined to be $0.994 would, upon ceasing to use the amortized cost method of valuation, begin to redeem shares at $0.994 (rather than at $0.990). *See generally id.*

[261] Item 2(c)(1)(ii) of Form N–1A [17 CFR 239.15A, 274.11A]. Similar disclosure is required in money market fund advertisements and sales literature. *See* rule 482(b)(4) under the Securities Act of 1933 [17 CFR 230.482]; rule 34b–1(a).

[262] *See* Press Release, The Reserve Fund, Timeframe for Initial Distribution Payment of Reserve Primary Fund (Sept. 30, 2008) (explaining that ''[m]oney market management systems * * * are programmed to accommodate a constant $1.00 NAV [and that making] a distribution to holders that have made redemption requests since September 15, 2008 necessitated a series of system modifications designed to ensure an accurate and equitable distribution of funds''); Press Release, The Reserve Fund, Reserve Primary Fund Disbursement Update (Oct. 15, 2008) (explaining that Reserve Fund investors were ''supported by complex technology at The Reserve as well as their own systems, which had to be adjusted due to the decline of the net asset value below $1.00 on September 16 * * * [and that The Reserve Fund was] working diligently to enhance * * * existing software and add new programs to hasten the distribution process''). *See also* Press Release, The Reserve Fund, Statement About The Reserve Yield Plus Fund (Oct. 17, 2008) (''apologiz[ing] for the delay in meeting redemption requests'' in a short-term bond fund, and explaining that the fund's sponsor needed to ''first move the Fund to a different computer platform that's able to account for a share price below $1.00 * * * [which] wasn't anticipated when the Fund was created'').

[263] Proposed 2a–7(c)(1) (new third sentence).

[264] Absent a Commission exemption, section 17(a)(2) prohibits any affiliated person or promoter of or principal underwriter for a fund (or any affiliated person of such a person), acting as principal, from knowingly purchasing securities from the fund. Rule 17a–9 exempts certain purchases of securities from a money market fund from section 17(a). For convenience, in this Release, we refer to all of the persons who would otherwise be prohibited by section 17(a)(2) from purchasing securities of a money market fund as ''affiliated persons.'' ''Affiliated person'' is defined in section 2(a)(3) of the Act.

fund portfolio securities.[265] The Commission is also proposing a related amendment to rule 2a–7, which would require that funds report all such transactions to the Commission.

1. Expanded Exemptive Relief

In 1996, the Commission adopted rule 17a–9 under the Act to permit affiliated persons to purchase a security from an affiliated money market fund that is no longer an eligible security under rule 2a–7, as long as the purchase price is paid in cash and is equal to the amortized cost of the security or its market price, whichever is greater.[266] The rule codified a series of staff no-action letters in which the staff agreed not to recommend enforcement action to the Commission if affiliated persons of a money market fund purchased portfolio securities from the fund in order prevent the fund from realizing losses on the securities that may otherwise have caused it to break the buck.[267] When we adopted the rule we explained that experience had shown that such transactions appeared to be fair, reasonable, in the best interests of fund shareholders, and consistent with the requirement that money market funds dispose of a defaulted security in an orderly manner as soon as practicable.[268]

The current rule exempts only purchases of securities that are no longer ''eligible securities'' under rule 2a–7 because, for example, their ratings have been downgraded. This limitation served as a proxy indicating that the market value of the security was likely less than its amortized cost value, and thus the resulting transaction was fair to the fund and did not involve overreaching.[269] Since rule 17a–9 was adopted, our staff has responded to several emergency requests for no-action relief for transactions involving portfolio securities that remained eligible securities. In some cases, the fund's adviser anticipated that the securities would be downgraded and sought to arrange a purchase by an affiliate as a preventive measure before the distressed security could impact the fund's market-based net asset value.[270] In other cases, markets for portfolio securities had become illiquid and the affiliated person sought to provide the fund with cash to satisfy redemptions by purchasing portfolio securities.[271] In all cases, the terms of the transactions met all the requirements of rule 17a–9 except that the securities were eligible securities.

Our staff's experience is that these transactions appear to be similarly fair and reasonable and in the best interest of shareholders. We are therefore proposing to extend the exemption to additional types of transactions, which will eliminate the need for affiliated persons to seek no-action assurances from our staff for these transactions when the delay would not be in the best interests of shareholders.

Currently, under rule 17a–9 a security must no longer be an eligible security for an affiliated person of a money market fund to purchase such security. Under the proposed amendment, a money market fund could sell a portfolio security that has defaulted (other than an immaterial default unrelated to the financial condition of the issuer), to an affiliated person, even though the security continued to be an eligible security.[272] Any such transaction would have to satisfy the existing requirements of rule 17a–9.[273]

In addition, we propose to add a new provision to rule 17a–9 that would permit affiliated persons, for any reason, to purchase other portfolio securities (*e.g.,* eligible securities that have not defaulted) from an affiliated money market fund for cash at the greater of its amortized cost value or market value, provided that such person promptly remits to the fund any profit it realizes from the later sale of the security.[274] Because in these circumstances there may not be an objective indication that the security is distressed (and thus that the transaction is clearly in the interest of the fund), the proposed ''claw-back'' provision would eliminate incentives for fund advisers and other affiliated persons to buy securities for reasons other than protecting fund shareholders from potential future losses.

We request comment on all aspects of the proposed expansion of rule 17a–9. Should we instead expand the exemption to include only those portfolio securities that fall within enumerated categories (*e.g.,* securities have defaulted, have become illiquid, have been determined by the board of directors to no longer present minimal credit risk)? If so, what would those categories be and why? Would any additional conditions be needed with respect to particular categories of purchases to control for potential conflicts of interest on the part of the adviser? Is so, what conditions should we include? Is it appropriate to subject only eligible securities that have not defaulted to the proposed claw-back provision? Is such a provision necessary and fair? Should we provide a time limit after purchase when the required claw-back provision would no longer apply? Should we exclude from the claw-back requirement potential payments to money market funds that are subsequently liquidated?

2. New Reporting Requirement

The Commission is also proposing an amendment to rule 2a–7 that would require a money market fund whose securities have been purchased by an affiliated person in reliance on rule 17a–9 to provide us with prompt notice of

[265] The proposed expansion of the rule would not include ''capital support agreements'' supporting the net asset value per share of money market funds, which support fund affiliates provided in several instances in reliance on no-action assurances by our staff. *See supra* note 38. Unlike direct purchases of securities by affiliates, the nature and terms of these agreements are highly customized and terminate after a limited period of time. As a result, these situations do not readily lend themselves to being addressed in a rule of general applicability.

[266] Rule 17a–9(a) and (b). *See* 1996 Adopting Release, *supra* note 20, at nn.190–94 and accompanying text.

[267] *See* 1996 Adopting Release, *supra* note 20, at nn.190–92 and accompanying text.

[268] *See id.*

[269] *See id.* at text following n.194 (''The rule, as adopted, is available for transactions involving securities that are no longer eligible securities because they no longer satisfy either the credit quality or maturity limiting provisions (*e.g.,* the securities are long-term adjustable-rate securities whose market values no longer approximate their par values on the interest rate readjustment dates).'').

[270] *See, e.g.,* Fixed Income Shares—Allianz Dresdner Daily Asset Fund, SEC Staff No-Action Letter (May 5, 2008); First American Funds, Inc.—Prime Obligation Fund, SEC Staff No-Action Letter (Dec. 3, 2007); MainStay VP Series Fund—MainStay VP Cash Management Portfolio, SEC Staff No-Action Letter (Oct. 22, 2008); Institutional Liquidity Trust—Prime Master Series, SEC Staff No-Action Letter (Apr. 30, 2008); Penn Series Funds, Inc.—Money Market Fund, SEC Staff No-Action Letter (Oct. 22, 2008); Phoenix Opportunities Trust—Phoenix Money Market Fund and Phoenix Edge Series Fund—Phoenix Money Market Series, SEC Staff No-Action Letter (Oct. 22, 2008); USAA Mutual Funds Trust—USAA Money Market Fund, SEC Staff No-Action Letter (Oct. 22, 2008). SEC staff no-action letters are available on the SEC Web site at *http://www.sec.gov/divisions/investment/im-noaction.shtml* under the hyperlink for the relevant letter.

[271] *See, e.g.,* Dreyfus Money Funds, SEC Staff No-Action Letter (Oct. 20, 2008); Mount Vernon Securities Lending Trust, Inc.—Mount Vernon Securities Lending Prime Portfolio, SEC Staff No-Action Letter (Oct. 22, 2008); Morgan Stanley Money Market Funds, SEC Staff No-Action Letter (Oct. 22, 2008); Reserve New York Municipal Money-Market Trust—New York Municipal Money-Market Fund, SEC Staff No-Action Letter (Nov. 18, 2008); Russell Investment Company—Russell Money Market Fund, SEC Staff No-Action Letter (Oct. 20, 2008).

[272] Proposed rule 17a–9(a). Other provisions of rule 2a–7 currently except immaterial defaults unrelated to the financial condition of the issuer. *See* rule 2a–7(c)(6)(ii)(A). As we have noted in the past, this exception is intended to exclude defaults that are technical in nature, such as where the obligor has failed to provide a required notice or information on a timely basis. *See* 1991 Adopting Release, *supra* note 20, at Section II.E.2.

[273] Proposed rule 17a–9(a)(1) and (2).

[274] Proposed rule 17a–9(b)(2).

the transaction via electronic mail.[275] We proposed a similar amendment last summer in connection with the NRSRO References Proposal.[276] That proposal is superseded by the requirement we propose here, which contains one change.[277] Due to the nature of the proposed amendments to rule 17a–9, which do not restrict the purchase of a portfolio security from a fund to particular categories, we propose to require not only notice of the fact of the purchase, but also the reasons for the purchase. Such reasons might include, for example, that the fund's adviser expected that the security would be downgraded, that due to the decreased market value of the security the fund was at risk of breaking the buck, or that the fund was experiencing heightened redemption requests and wished to avoid a ''fire sale'' of assets to satisfy such requests.

We continue to believe that the current notice requirement in rule 2a–7, which is triggered when a security over a threshold amount of the fund's assets defaults, provides us with incomplete information about money market fund holdings of distressed securities, particularly those that have engaged in affiliated transactions.[278] We also continue to believe that this proposed notice requirement, which is a concept supported by some commenters last summer,[279] would impose little burden on money market funds or their managers, and would enhance our oversight of money market funds especially during times of economic stress. We request comment on this proposed notice requirement. Is the proposed requirement that the notice include the reasons for the purchase by the affiliate sufficiently clear? Should we require that any additional information be included in the notice and should the notice take a particular form?

[275] Proposed rule 2a–7(c)(7)(iii)(B). The electronic mail notification would be directed to the Director of our Division of Investment Management, or the Director's designee. Proposed rule 2a–7(c)(7)(iii).

[276] *See* NRSRO References Proposal, *supra* note 105, at n.35 and accompanying text.

[277] Proposed rule 2a–7(c)(7)(iii)(B).

[278] *See* NRSRO References Proposal, *supra* note 105, at Section III.A.4.

[279] *See, e.g.,* Comment Letters of the Investment Company Institute (Sept. 5, 2008); Commenter Letter of the Mutual Fund Directors Forum (Sept. 5, 2008); Comment Letter of OppenheimerFunds, Inc. (Sept. 4, 2008); Comment Letter of Charles Schwab Co., Inc. (Sept. 5, 2008). Comment letters may be accessed on the Commission's Web site at *http://www.sec.gov/comments/s7-19-08/s71908.shtml.*

### *I. Fund Liquidation*

#### 1. Proposed Rule 22e–3

The Commission is proposing a new rule 22e–3, which would exempt money market funds from section 22(e) to permit them to suspend redemptions in order to facilitate an orderly liquidation of the fund. The new rule would replace rule 22e–3T, a temporary rule that provides a similar exemption for money market funds participating in the Treasury Department's Guarantee Program.[280]

Section 22(e) of the Act generally prohibits funds, including money market funds, from suspending the right of redemption, and from postponing the payment or satisfaction upon redemption of any redeemable security for more than seven days. The provision was designed to prevent funds and their investment advisers from interfering with the redemption rights of shareholders for improper purposes, such as the preservation of management fees.[281] Although section 22(e) permits funds to postpone the date of payment or satisfaction upon redemption for up to seven days, it does not permit funds to suspend the right of redemption, absent certain specified circumstances or a Commission order.

As discussed above, on September 22, 2008, we issued an order under section 22(e) to permit two series of The Reserve Fund to suspend redemptions and postpone payments in the midst of a run on the fund. In November 2008, we adopted rule 22e–3T to permit money market funds participating in the Treasury's Guarantee Program to suspend redemptions and postpone the payment of redemption proceeds if a fund breaks the buck and begins liquidation proceedings under the Guarantee Program.[282]

The temporary rule was intended to facilitate the orderly disposal of assets in a manner that would protect the interests of all shareholders. Absent the exemption provided by rule 22e–3T, a fund participating in the Guarantee Program that faces a run would be compelled by section 22(e) to continue to redeem shares. In order to raise the money to pay redemption proceeds to shareholders, a fund may have to sell portfolio securities. Massive redemption requests could thus force a fund to liquidate positions in a fire sale, further depressing the fund's market value share price. Earlier redeeming shareholders would receive higher share prices (at or near the amortized cost) but, as a result of the fund's diminishing asset base, later redeeming shareholders may receive lower prices.[283] Moreover, as demonstrated by the events of last fall, a run on a single fund can quickly spread to other funds and, as multiple funds attempt to meet redemption requests, seriously deplete the value of portfolio holdings and drain the availability of cash and more liquid securities.

We believe that rule 22e–3T, which will expire on October 18, 2009 in conjunction with the Guarantee Program, should be replaced with a rule that would provide for a similar exemption independent of the Guarantee Program.[284] Proposed rule 22e–3 would permit all money market funds to suspend redemptions upon breaking a buck, if the board, including a majority of independent directors, approves liquidation of the fund, in order to liquidate in an orderly manner. The proposed rule is intended to reduce the vulnerability of investors to the harmful effects of a run on a fund, and minimize the potential for disruption to the securities markets.

Proposed rule 22e–3(a) would permit a money market fund to suspend redemptions if: (i) The fund's current price per share, calculated pursuant to rule 2a–7(c), is less than the fund's stable net asset value per share; (ii) its board of directors, including a majority of directors who are not interested

[280] The Treasury's Guarantee Program guarantees that shareholders of a participating money market fund will receive the fund's stable share price for each share owned as of September 19, 2008, if the fund liquidates under the terms of the Program. *See supra* note 55 and accompanying text.

[281] *See Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 291 (1940) (statement of David Schenker, Chief Counsel, Investment Trust Study, SEC).

[282] *See* Rule 22e–3T Adopting Release, *supra* note 31.

[283] *Id.*

[284] One commenter on rule 22e–3T recommended that we make the rule a permanent rule for any fund preparing to liquidate, independent of the Guarantee Program. *See* Comment Letter of the Investment Company Institute (Dec. 24, 2008). Two other comment letters related to matters unique to the Guarantee Program. *See* Comment Letter of the Coalition of Mutual Fund Investors (Dec. 14, 2008) (recommending that any fund that liquidates and relies on the Guarantee Program be required to provide information obtained pursuant to rule 22c–2 under the Investment Company Act); Comment Letter of Michael F. Johnson (Nov. 20, 2008) (requesting information concerning the applicability of the Guarantee Program to a particular fund). The only other comment letter that the Commission received concerning interim final rule 22e–3T was a letter from the Committee of Annuity Insurers, discussed below. *See infra* note 288 and accompanying text. Comments on interim final rule 22e–3T, File No. S7–32–08, are available at *http://www.sec.gov/comments/s7-32-08/s73208.shtml.* Once rule 22e–3T expires, the Commission would stand ready to consider applications for exemptive relief under section 22(e).

persons, approves the liquidation of the fund; and (iii) the fund, prior to suspending redemptions, notifies the Commission of its decision to liquidate and suspend redemptions, by electronic mail directed to the attention of our Director of the Division of Investment Management or the Director's designee.[285] These proposed conditions are intended to ensure that any suspension of redemptions will be consistent with the underlying policies of section 22(e). We understand that suspending redemptions may impose hardships on investors who rely on their ability to redeem shares. Accordingly, our proposal is limited to permitting suspension of this statutory protection only in extraordinary circumstances. Thus, the proposed conditions, which are similar to those of the temporary rule, are designed to limit the availability of the rule to circumstances that present a significant risk of a run on the fund. Moreover, the exemption would require action of the fund board (including the independent directors), which would be acting in its capacity as a fiduciary.[286]

The proposed rule contains an additional provision that would permit us to take steps to protect investors. Specifically, the proposed rule would permit us to rescind or modify the relief provided by the rule (and thus require the fund to resume honoring redemptions) if, for example, a liquidating fund has not devised, or is not properly executing, a plan of liquidation that protects fund shareholders.[287] Under this provision, the Commission may modify the relief ''after appropriate notice and opportunity for hearing,'' in accordance with section 40 of the Act.

Paragraph (b) of the proposed rule would provide a limited exemption from section 22(e) for certain conduit funds that invest, pursuant to section 12(d)(1)(E) of the Act, all of their assets in a money market fund that suspends redemption in reliance on paragraph (a) of the proposed rule.[288] Without this exemption, these conduit funds may be placed in the position of having to honor redemption requests while being unable to liquidate shares of money market funds held as portfolio securities. We anticipate that this provision would be used principally by insurance company separate accounts issuing variable insurance contracts and by funds participating in master-feeder arrangements.[289]

We request comment generally on all aspects of proposed rule 22e–3. Is it appropriate to permit money market funds that break the buck to suspend redemptions during liquidation? Should the exemption be available to other types of open-end investment companies? Should there be additional or alternative conditions with regard to the exemption (*e.g.,* should the fund be required to disclose its liquidation plan to shareholders)? Should there be a limit on the suspension period so that shareholder assets are not ''locked up'' for an unduly lengthy period? If so, what should be the maximum length of the suspension period (*e.g.,* 60 or 90 days)?

2. Request for Comment on Other Regulatory Changes

We also request comment on certain additional changes that we are considering but are not currently proposing, relating to the suspension of redemptions that may provide additional protections to money market fund investors.

a. Temporary Suspensions for Exigent Circumstances

Should we include a provision in rule 22e–3 that would permit fund directors to temporarily suspend redemptions during certain exigent circumstances other than liquidation of the fund? The ICI Report recommends that we permit a fund's directors to suspend temporarily the right of redemption if the board, including a majority of its independent directors, determines that the fund's net asset value is ''materially impaired.''[290] Under this approach, the fund could suspend redemptions for up to five days, during which time the fund could attempt to restore its net asset value (*e.g.,* by securing credit support agreements). In the event that the fund could not restore its net asset value within that period, the fund would be required to begin the liquidation process. A fund would be permitted to exercise this option only once every five years. This ''time out'' could give money market funds some time during turbulent periods to assess the viability of the fund.[291]

We request comment generally on whether we should provide this additional relief. Would it make money market funds less appealing to investors? Would it provide time for directors to find a solution? Or might it accelerate redemptions from shareholders once the suspension period ends, regardless of any action taken by the board of directors?[292] Could the accumulating redemptions ''hanging over the fund'' place pressure on the prices of fund portfolio securities? How could we ensure that directors would use this authority only in exigent circumstances? When is a money market fund's net asset value ''materially impaired''? Would this term include circumstances in which the fund has overvalued securities, which, if sold to satisfy redemptions, would have to be marked down?

We also request comment on how a temporary suspension should operate. What disclosures should a money market fund be required to make, and when and where should the fund make them? Should a fund be required to calculate its net asset value during the suspension period, and, if so, should the net asset value be publicly disclosed? Should the suspension period be longer or shorter than five days? What factors should the board of directors take into consideration when deciding whether to suspend redemptions temporarily? How would directors weigh the various and possibly competing interests of shareholders?

b. Options for Shareholders in Liquidating Funds

If a fund suspends redemptions in order to liquidate, the directors would likely distribute money to investors as it becomes available from the sale of portfolio securities, while maintaining a reserve to cover expenses and potential liabilities. As we have seen, this process

[285] Proposed rule 22e–3(a).

[286] We also note that the potential for abuse may be mitigated because the impending liquidation of the fund would ultimately eliminate a source of advisory fees for the adviser. *See* Rule 22e–3T Adopting Release, *supra* note 31, at text accompanying nn.19–20.

[287] Proposed rule 22e–3(c). We adopted a similar provision in rule 22e–3T. Rule 22e–3T(b); *see also* Rule 22e–3T Adopting Release, *supra* note 31.

[288] Proposed rule 22e–3(b). This provision is based on a suggestion we received in a comment letter submitted in connection with rule 22e–3T. *See* Comment Letter of the Committee of Annuity Insurers (Dec. 23, 2008) (requesting that the Commission extend the application of rule 22e–3T to insurance company separate accounts). Proposed rule 22e–3(b) also would require a fund to promptly notify the Commission that it has suspended redemptions in reliance on the rule.

[289] For a discussion of master-feeder arrangements, *see supra* note 194.

[290] ICI Report, *supra* note 6, at 85–89.

[291] Similarly, the Treasury's Guarantee Program and rule 22e–3T effectively provide funds with the ability to temporarily suspend redemptions. The Guarantee Program requires funds that break the buck to commence liquidation proceedings within five days, unless the fund restores its net asset value to a level equal to or above $0.995 within that period. Meanwhile, rule 22e–3T permits funds to suspend redemptions if a fund breaks the buck and has not yet ''cured'' the event.

[292] In other situations, temporary restrictions on redemptions may have exacerbated the situation and increased the rate of redemptions. *See* Svea Herbst-Bayliss, *''Gates'' May Have Hurt More Than Helped Hedge Funds,* Reuters, Mar. 26, 2009, available at *http://www.reuters.com/article/PrivateEquityandHedgeFunds09/idUSTRE52P4JJ20090326.*

can be lengthy. Should we include conditions in any rule regarding the treatment of shareholders in a liquidation? [293] For example, should we require that fund assets be distributed on a pro rata basis? Should there be a limit on allowable reserves?

Alternatively, should we permit or require a fund board to recognize that investors will have different preferences for liquidity and capital preservation? For example, a fund that decides to liquidate and suspend redemptions could be allowed to offer shareholders the choice of redeeming their shares immediately at a reduced net asset value per share that reflects the fair market value of fund assets, *i.e.,* at a price below the fund's stable net asset value. Remaining shareholders would receive their redemption proceeds at the end of the liquidation process and may receive the economic benefit of an orderly disposal of assets. Would such an approach be fair to all fund shareholders? What conditions would be necessary and appropriate to ensure that shareholders are treated fairly? Specifically, how would such a mechanism operate? Should funds be able to deduct an additional discount or ''haircut'' from earlier redeeming shareholders to provide additional protection for later redeeming shareholders? Should we permit boards to decide the amount of the haircut? If so, what factors should boards use to decide such haircuts? What disclosures and information would be necessary to permit shareholders to make an informed decision between the options?

Should investors be required to choose their preferences at the time they purchase fund shares? Should investors be able to change their preferences? If so, how and when? Should they be able to choose their preferences when a fund announces its intention to liquidate and suspend redemptions under the rule? If so, should we (or the fund board) establish a default assumption for investors that fail to respond to the inquiry?

## III. Request for Comment

The Commission requests comment on the rules and amendments proposed in this release. Commenters are requested to provide empirical data to support their views. The Commission also requests suggestions for additional changes to existing rules or forms, and comments on other matters that might have an effect on the proposals contained in this release.

We recognize that the events of the last two years raise the question of whether further and perhaps more fundamental changes to the regulatory structure governing money market funds may be warranted. Therefore we are exploring other ways in which we could improve the ability of money market funds to weather liquidity crises and other shocks to the short-term financial markets. We invite interested persons to submit comments on the advisability of pursuing any or all of the following possible reforms, as well as to provide other approaches that we might consider to achieve our goals. We expect to benefit from the comments we receive before deciding whether to propose these changes.[294]

### *A. Floating Net Asset Value*

When the Commission adopted rule 2a–7 in 1983,[295] it facilitated money market funds' maintenance of a stable net asset value by permitting them to use the amortized cost method of valuing their portfolio securities. As discussed above, section 2(a)(41) of the Act, in conjunction with rules 2a–4 and 22c–1, normally require a registered investment company to calculate its current net asset value per share by valuing its portfolio securities for which market quotations are readily available at current market value and its other securities at their fair value as determined, in good faith, by the board of directors. Therefore, using the amortized cost method of valuation is an exception to the general requirement under the Act that investors in investment companies should pay and receive market value or fair value for their shares.[296] The Commission did not take lightly its decision to permit money market funds to use the amortized cost method of valuation. Rule 2a–7 essentially codified several of the Commission's exemptive orders relating to money market funds, and these orders were issued only after an administrative hearing in the late 1970s at which the use of the amortized cost method of valuation was a matter of considerable debate.[297]

The balance the Commission struck was that, in exchange for permitting this valuation method, it would impose certain conditions on money-market funds designed to ensure that these funds invested only in instruments that would tend to promote a stable net asset value per share and would impose on the funds' boards of directors an ongoing obligation to determine that it remains in the best interest of the funds and their shareholders to maintain a stable net asset value. Further, money market funds are permitted to use the amortized cost method of valuation only so long as their boards believe that it fairly reflects the funds' market-based net asset value per share.[298]

The $1.00 stable net asset value per share has been one of the trademark features of money market funds. It facilitates the funds' role as a cash management vehicle, provides tax and administrative convenience to both money market funds and their shareholders,[299] and promotes money market funds' role as a low-risk investment option. Many investors may hold shares in money market funds in large part because of these features.[300] We are mindful that if we were to require a floating net asset value, a substantial number of investors might

[293] The Investment Company Act does not contain any provisions governing the liquidation of an investment company, including a money market fund; rather, liquidations are primarily effected in accordance with applicable state law. The Act does include, however, a provision authorizing Federal district courts to enjoin a plan of reorganization upon a proceeding initiated by the Commission on behalf of security holders, if the court determines that the plan of reorganization is not ''fair and equitable to all security holders.'' Section 25(c) of the Act. A plan of ''reorganization'' includes a voluntary dissolution or liquidation of a fund. Section 2(a)(33) of the Act.

[294] In addition, we note that the U.S. Department of the Treasury's white paper on Financial Regulatory Reform calls for the President's Working Group on Financial Markets to prepare a report by September 15, 2009 assessing whether more fundamental changes are necessary to further reduce the money market fund industry's susceptibility to runs, such as eliminating the ability of a money market fund to use a stable net asset value or requiring money market funds to obtain access to reliable emergency liquidity facilities from private sources. *See* Department of the Treasury, Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation, at 38–39 (June 2009).

[295] *See* 1983 Adopting Release, *supra* note 3.

[296] Rule 2a–7 is not the only exception permitting open-end investment companies to value short-term debt securities in their portfolios on an amortized cost basis. Subject to certain conditions, the amortized cost method of valuation may be used by open-end investment companies to value investments with a remaining maturity of 60 days or less in accordance with the Commission's interpretation set forth in Valuation of Debt Instruments by Money Market Funds and Certain Other Open-End Investment Companies, Investment Company Act Release No. 9786 (May 31, 1977) [42 FR 28999 (June 7, 1977)].

[297] *See* 1982 Proposing Release, *supra* note 25, at text preceding, accompanying, and following nn.2–4.

[298] *See* rule 2a–7(c)(1).

[299] A $1.00 stable net asset value per share relieves shareholders of the administrative task of tracking the timing and price of purchase and sale transactions for capital gain and wash sale purposes under tax laws.

[300] Some institutional investors are prohibited by board-approved guidelines or firm policies from investing certain assets in money market funds unless they have a stable net asset value per share. *See* ICI Report, *supra* note 6, at 109. One survey also reported that 55% of institutional cash managers would substantially decrease their investments in money market funds if the funds had a floating value. *See id.* at 110 (citing a January 2009 survey by Treasury Strategies, Inc.).

move their investments from money market funds to other investment vehicles.

However, a stable $1.00 net asset value per share also creates certain risks for a money market fund and its investors. These risks are a consequence of the amortized cost method of valuation and the resulting insensitivity of the $1.00 net asset value per share to market valuation changes. It may create an incentive for investors to redeem their shares when a fund's market-based net asset value per share falls between $0.995 and $1.00 because they will obtain $1.00 in exchange for their right to fund assets worth less than $1.00 per share. Regardless of the motivation underlying the redemptions, the unrealized losses attributable to redeeming shareholders are now borne by the remaining money market fund shareholders.

Further, particularly in times of market turbulence and illiquidity, regardless of the motivation behind the redemptions, redemptions at $1.00 in a money market fund whose market-based net asset value is below $1.00 can further depress the fund's market-based net asset value, exacerbating the impact on remaining shareholders. It can create a level of unfairness in permitting the remaining fund shareholders to pay for the liquidity needs and unrealized losses of redeeming fund shareholders. Because there is a limited window where only so many shareholders can redeem at $1.00 in a fund with a portfolio under threat (because of holding distressed securities or facing significant shareholder redemptions) before the board of the fund must consider whether to re-price the fund's shares or take other action, there can be an incentive to be the first shareholder to place a redemption request upon any hint of stress at a money market fund. Generalized market dislocations or illiquidity can create this stress on a number of money market funds simultaneously, leading to runs on money market funds similar to those we witnessed in September 2008. Even further, a run may result in fire sales of securities, placing pressure on market prices and transmitting problems that may be originally associated with a single money market fund to other money market funds. Finally, larger, institutional money market fund investors, especially those with fiduciary responsibilities for managing their clients' assets, are more likely to recognize negative events potentially affecting the money market fund and to be in a position to quickly redeem shares of the money market fund and thus protect their money market investments and those of their clients, leaving other smaller, more passive money market investors to bear their losses.

When we determined to permit money market funds to use amortized cost valuation in 1983, money market funds held only about $180 billion in assets [301] and played a minor role in the short-term credit markets. Their principal benefit was to provide retail investors with a cash investment alternative to bank deposits, which at the time paid fixed rates substantially below short-term money market rates. Since that time, money market funds have grown tremendously and have developed into an industry driven in large part by institutional investors, who hold approximately 67 percent of the over $3.7 trillion in money market fund assets.[302] As noted earlier, with the ability of institutional investors today to make hourly redemption requests to money market funds, these investors have the ability to move substantial amounts of money in and out of money market funds (or between money market funds), with potentially detrimental effects on the funds, their remaining shareholders, and the marketplace.

The influx of institutional investments in money market funds, the increased transparency of fund holdings, and the speed with which large shareholders can buy and redeem shares may have increased the possibility that the value of some fund investors' shares will be diluted as a result of the fund's use of the amortized cost valuation method.[303] When short-term interest rates decrease, the fund's portfolio holdings (with their now above-market yields) become more valuable. Institutional investors may pay $1.00 per share to purchase fund shares whose market value is, for example, $1.002 per share. Such institutional inflows would be invested by the fund in securities offering the new, reduced market yields, diluting the yield advantage that existing fund shareholders would otherwise enjoy. These institutional investors, in effect, are able to earn a yield through a money market fund above the market rate they could earn on a direct investment. They achieve this yield advantage by capturing a portion of the benefit from declining interest rates that otherwise would benefit existing money market fund investors.[304] Similarly, when interest rates increase, institutional investors could sell shares of money market funds, obtaining $1.00 per share for a fund that all things being equal likely will be worth less, *e.g.,* $0.997 per share.[305] If instead the institutional investor sells commercial paper in the market under the same conditions, it could only sell such securities at a discount.

In stable markets and with small shareholdings, amortized cost pricing at most results in shareholders who purchase or redeem shares receiving slightly more or less (in shares or in redemption proceeds) than they otherwise would if the fund's net asset value were to fluctuate according to market-based pricing. Net redemptions generally are funded by cash on hand. Any deviation between the market-based net asset value per share of the fund and its amortized cost value is small enough to have an immaterial effect on the fund, and no effect on investors. It could be compared to a rounding convention in a billing system.

In a market under significant stress and with institutions holding billions of dollars of money market fund shares, however, a real arbitrage opportunity can arise, and a race or threat of a potential race for redemptions may become a real possibility. For example, during last fall's market turbulence, as credit spreads on many money market fund portfolio securities widened and the market value of these securities fell, we understand that the market-based net asset value of some money market funds dropped low enough that redemptions by a few large shareholders in the fund at $1.00 per share alone could have caused the fund to break the buck.

We recognize that a floating net asset value would not necessarily eliminate the incentive to redeem shares during a liquidity crisis—shareholders still

[301] *See* ICI Report, *supra* note 6, at 1.

[302] *See* ICI Mutual Fund Historical Data, *supra* note 47 (data for week ended June 10, 2009).

[303] We have considered the impact of dilution in money market funds using the amortized cost method of valuation in the past. *See, e.g.,* 1982 Proposing Release, *supra* note 25, at n.6 and accompanying text.

[304] This benefit would otherwise be paid out to money market fund shareholders in the form of greater dividend payments from the increased yield.

[305] *See* S&P 2007 Ratings Criteria, *supra* note 139, at 27. Standard and Poor's gives the example of an investor holding $1 million in 90-day U.S. Treasury bills yielding 5%. If interest rates increased 150 basis points, the value of the investment would drop by approximately $3700 and the investor's yield would remain at 5%. Compare this to an investor holding one million shares of a money market fund holding exclusively Treasury bills yielding 5% (setting aside fund expenses). If interest rates rose 150 basis points, the investor could sell the fund investment for $1.00 per share and not experience any loss. The investor could then purchase 90-day Treasury bills yielding 6.5%, instantaneously increasing its return by 1.5%. If the fund is forced to sell these securities to meet redemption requests, the $3700 unrealized loss would be borne by the fund and its remaining shareholders.

would have an incentive to redeem before the portfolio quality deteriorated further from the fund selling securities into an illiquid market to meet redemption demands. But a floating net asset value may lessen the impact of any portfolio deterioration by eliminating the ability of shareholders to redeem their shares for more than the current market value per share of the fund's portfolio. It also might better align investors' expectations of risk with the actual risks posed by money market fund investments. We expect that, at least under stable market conditions, the other risk-limiting conditions of rule 2a–7 would tend to promote a relatively stable net asset value per share even if we eliminated the ability of money market funds to rely on the amortized cost method of valuation.

We request comment on the possibility of eliminating the ability of money market funds to use the amortized cost method of valuation. Would such a change render money market funds a more stable investment vehicle? Would it lessen systemic risk by making money market funds less susceptible to runs? Would it make the risks inherent in money market funds more transparent? Many money market funds' stable net asset value was supported voluntarily by fund affiliates over the last two years, and shareholders may not have understood that this support was provided on a voluntary basis and may not be provided in the future.

On the other hand, would such a change make money market funds more susceptible to runs because investors might respond quickly to small changes in net asset value? As discussed above, a stable net asset value per share creates certain administrative, tax, and cash management conveniences for fund investors. Accordingly, would prohibiting the use of the amortized cost method of valuation in money market funds encourage investors to shift assets from money market funds to unregulated offshore funds, bank accounts, or other investments? Would it result in some institutional money market funds deregistering with the Commission (in reliance on section 3(c)(7) of the Act) in order to continue to maintain a stable net asset value? Is this a result with which the Commission should be concerned?

What impact would this have on investors' cash management activities? What impact might such a change have on the short-term credit markets and issuers of short-term debt securities? How would money market funds whose share prices were based on market-based net asset values differ from current short-term bond funds? Should any rule amendment eliminating the ability of money market funds to rely on the amortized cost method of valuation to create a stable net asset value be limited to institutional money market funds? As discussed above, institutional money market funds are at greater risk of instability, runs and the dilutive effect of large redemptions.

### *B. In-Kind Redemptions*

As noted above, one of our concerns relates to the ability of large institutional shareholders to rapidly redeem substantial amounts of fund assets, which can pose a threat to the stable net asset value of the fund and can advantage one group of shareholders over another by requiring remaining shareholders to pay for the liquidity needs of large redeeming shareholders.[306] While the liquidity requirements we are proposing today may ameliorate pressures created by redeeming shareholders, during severe market dislocations even more steps may be necessary to help ensure the stability of a stable net asset value money market fund. Accordingly, if we retain a stable net asset value for money market funds, we are interested in exploring other methods of reducing the risks and unfairness posed by significant sudden redemptions.

One possible way of addressing these issues would be to require that funds satisfy redemption requests in excess of a certain size through in-kind redemptions.[307] Money market funds currently are permitted to and many money market funds disclose in their prospectuses that they may satisfy redemption requests through in-kind redemptions.[308] In the wake of last fall's redemption pressures on money market funds, however, only one announced that it would do so.[309] In-kind redemptions would lessen the impact of large redemptions on remaining money market fund shareholders and would require the redeeming investor to bear part of the cost of its liquidity needs. If shareholders did not immediately sell these securities, requiring in-kind redemptions in such circumstances may mitigate the impact of large redemptions on short-term credit markets by reducing the likelihood of large fire sales of short-term securities into the market. Finally, it also may encourage large investors to diversify their money market fund holdings among a variety of funds, perhaps lessening the risk that any individual fund would be threatened by a few redemptions.[310] If proposed, we would expect to set a threshold for requiring in-kind redemptions sufficiently high that we could reasonably assume that such an investor would be in the position to assume ownership of such securities.

We request comment on requiring money market funds to satisfy redemption requests in excess of a certain size through in-kind redemptions. What would be the advantages and disadvantages of this approach? What type of threshold redemption request should trigger this requirement? Should there be a different threshold for third-party shareholders versus affiliated shareholders of a money market fund? Should there be other restrictions on affiliate redemptions (*e.g.,* prioritizing non-affiliate redemptions over affiliate redemption requests that are submitted on the same day)? How should the fund determine the value of the securities to be distributed as a result of such a redemption request? The securities' amortized cost value? The securities' fair value, as determined based on current market quotations or, if no such quotations are readily available, as determined in good faith by the fund's board of directors? Would these shareholders be able to assume ownership of such securities?

We note that a board of directors alternatively could cause a money market fund to impose a redemption fee under rule 22c–2 to impose some of the fund's costs from shareholders' liquidity

[306] This situation to some extent could be analogized to the situation that can be created by market timing in which selling shareholders receive benefits to the detriment of remaining mutual fund shareholders.

[307] An in-kind redemption occurs when a shareholder's redemption request to a fund is satisfied by distributing to that shareholder portfolio assets of that fund instead of cash.

[308] *See* section 2(a)(32) of the Act (defining a redeemable security as a security where the holder ''is entitled * * * to receive approximately his proportionate share of *the issuer's current net assets,* or the cash equivalent thereof'' (italics added)). *See also* rule 18f–1, which provides an exemption from certain prohibitions of section 18(f)(1) of the Act with regard to redemptions in kind and in cash.

[309] On September 19, 2008, the American Beacon Money Market Portfolio announced it would honor redemption requests exceeding $250,000 in a 90-day period through pro rata payments of cash and ''in-kind'' distributions of securities held by the fund, to prevent redemptions from ''forcing'' the sale of fund assets. *See* American Beacon Funds, Prospectus Supplement for BBH ComSet Class, Institutional Class, Cash Management Class, and PlanAhead Class (Sept. 30, 2008), *available at http://www.sec.gov/Archives/edgar/data/809593/000080959308000045/sep3008_prosuppbeacon.txt.*

[310] Large investors that did not wish to receive in-kind redemptions could avoid this risk by spreading their investments among several money market funds such that no single money market fund investment was large enough to possibly trigger the in-kind redemption requirement.

needs on the redeeming shareholders.[311] What would be the advantages and disadvantages of this alternative approach to addressing our concerns regarding significant shareholder redemptions?

## IV. Paperwork Reduction Act Analysis

Certain provisions of the proposed amendments to rules 2a–7 and 30b1–5 and proposed new rules 22e–3 and 30b1–6 and Form N–MFP under the Investment Company Act contain ''collections of information'' within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[312] The titles for the existing collections of information are: (1) ''Rule 2a–7 under the Investment Company Act of 1940, Money market funds'' (OMB Control No. 3235–0268); (2) ''Rule 30b1–5 under the Investment Company Act of 1940, Quarterly filing of schedule of portfolio holdings of registered management investment companies'' (OMB Control No. 3235–0577); and (3) ''Form N–Q under the Investment Company Act of 1940, Quarterly Schedule of Portfolio Holdings of Registered Management Investment Company'' (OMB Control No. 3235–0578). The titles for the new collections of information are: (1) ''Rule 22e–3 under the Investment Company Act of 1940, Exemption for liquidation of money market funds;'' (2) ''Rule 30b1–6 under the Investment Company Act of 1940, Monthly report for money market funds;'' and (3) ''Form N–MFP under the Investment Company Act of 1940, Portfolio Holdings of Money Market Funds.'' The Commission is submitting these collections of information to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. Our proposed amendments and new rules are designed to make money market funds more resilient to risks in the short-term debt markets, and to provide greater protections for investors in a money market fund that is unable to maintain a stable net asset value per share. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

### *A. Rule 2a–7*

Rule 2a–7 under the Investment Company Act exempts money market funds from the Act's valuation requirements, permitting money market funds to maintain stable share pricing, subject to certain risk-limiting conditions. As discussed above, we are proposing to amend rule 2a–7 in several respects. Our proposal would amend the rule by: Revising portfolio quality and maturity requirements; introducing liquidity requirements; requiring money market fund boards to adopt procedures providing for periodic stress testing of the fund's portfolio; requiring funds to disclose monthly on their websites information on portfolio securities; and finally, requiring money market fund boards to determine, at least once each calendar year, that the fund has the capability to redeem and issue its securities at prices other than the fund's stable net asset value per share.[313] Three of the proposed amendments would create new collection of information requirements. The respondents to these collections of information would be money market funds or their advisers, as noted below.

1. Stress Testing

The proposed amendments would require money market fund boards to adopt written procedures that provide for the periodic testing of the fund's ability to maintain a stable net asset value per share based on certain hypothetical events.[314] These procedures also would have to provide for a report of the testing results to be submitted to the board of directors at its next regularly scheduled meeting, and 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.[315] Compliance with this proposed disclosure requirement would be mandatory for any fund that holds itself out as a money market fund in reliance on rule 2a–7. The information when provided to the Commission in connection with staff examinations or investigations would be kept confidential to the extent permitted by law.

We anticipate that stress testing would give fund advisers a better understanding of the effect of potential market events and shareholder redemptions on their funds' ability to maintain a stable net asset value, the fund's exposure to that risk, and actions the adviser may need to take to mitigate the possibility of the fund breaking the buck.

Commission staff believes that in light of the events of last fall most, if not all, money market funds currently conduct some stress testing of their portfolios as a matter of routine fund management and business practice.[316] These procedures likely vary depending on the fund's investments. For example, a prime money market fund that is offered to institutional investors may test for hypothetical events such as potential downgrades or defaults in portfolio securities while a U.S. Treasury money market fund may not. Some funds that currently conduct testing may be required to include additional hypothetical events under our proposed amendments. These funds likely provide regular reports of the test results to senior management. We expect, however, that most funds do not have written procedures documenting the stress testing, do not report the results of testing to their boards of directors, and do not provide an assessment from the fund's adviser regarding the fund's ability to withstand the hypothetical events reasonably likely to occur in the next year.

Commission staff believes that the stress testing procedures are or would be developed for all the money market funds in a fund complex by the fund adviser, and would address appropriate variations for individual money market funds within the complex. Staff estimates that it would take a fund adviser an average of 21 hours for a portfolio risk analyst initially to draft procedures documenting the complex's stress testing, and 3 hours for the board of directors to consider and adopt the written procedures. We estimate that 171 fund complexes with money market funds are subject to rule 2a–7. We therefore estimate that the total burden to draft these procedures initially would

[311] The redemption fee cannot exceed two percent of the value of the shares redeemed.

[312] 44 U.S.C. 3501–3521.

[313] *See supra* Section II.A–G.

[314] Proposed rule 2a–7(c)(8)(ii)(D). These events would include, but would not be limited to, a change in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on portfolio securities, and the widening or narrowing of spreads between yields on an appropriate benchmark the fund has selected for overnight interest rates and commercial paper and other types of securities held by the fund.

[315] Proposed rule 2a–7(c)(8)(ii)(D)(2), (3). The report to the board would include the dates on which the testing was performed and the magnitude of each hypothetical event that would cause the deviation of the money market fund's net asset value calculated using available market quotations (or appropriate substitutes that reflect current market conditions) from its net asset value per share calculated using amortized cost to exceed ½ of 1 percent.

[316] The estimates of hour burdens and costs provided in the PRA and cost benefit analyses are based on staff discussions with representatives of money market funds and on the experience of Commission staff. We expect that the board of directors would be the same for all the money market funds in a complex, and thus could adopt the stress test procedures for all money market funds in the complex at the same meeting.

be 4104 hours.[317] Amortized over a three-year period, this would result in an average annual burden of 8 hours for an individual fund complex and a total of 1368 hours for all fund complexes.[318] Staff estimates that a risk analyst also may spend an average of 6 hours per year revising the written procedures to reflect changes in the type or nature of hypothetical events appropriate to stress tests and the board would spend 1 hour to consider and adopt the revisions, for a total annual burden of 1197 hours.[319] Commission staff estimates further that it would take an average of 10 hours of portfolio management time to draft each report to the board of directors, 2 hours of an administrative assistant's time to compile and copy the report and 15 hours of the fund adviser's time to provide an assessment of the funds' ability to withstand reasonably likely hypothetical events in the coming year. The report must be provided at the next scheduled board meeting, and we estimate that the report would cover all money market funds in a complex. We also believe that the fund adviser would provide an assessment each time it provided a report. Finally, we assume that funds would conduct stress tests no less than monthly. With an average of 6 board meetings each year, we estimate that the annual burden would be 162 hours for an individual fund complex with a total annual burden for all fund complexes of 27,702 hours.[320]

The proposed amendment would require the fund to retain records of the reports on stress tests and the assessments for at least 6 years (the first two in an easily accessible place).[321] The retention of these records would be necessary to allow the staff during examinations of funds to determine whether a fund is in compliance with the stress test requirements. We estimate that the burden would be 10 minutes per fund complex per meeting to retain these records for a total annual burden of 171 hours for all fund complexes.[322]

Thus, we estimate that for the three years following adoption, the average annual burden resulting from the stress testing requirements would be 178 hours for each fund complex with a total of 30,438 hours for all fund complexes.[323]

We request comment on these estimates of hourly burdens. Would funds develop stress tests on a complex-wide basis for money market funds? Would the adviser prepare one report regarding stress tests for all the money market funds in a complex, or prepare a separate report for each money market fund?

2. Public Web site Posting

The proposed amendments would require money market funds to post monthly portfolio information on their Web sites.[324] We believe that greater transparency of fund portfolios may allow investors to exert influence on risk-taking by fund advisers, and thus reduce the likelihood that a fund will break the buck. Information will be posted on a public Web site, and compliance with this requirement would be mandatory for any fund that holds itself out as a money market fund in reliance on rule 2a–7. We estimate that there are approximately 750 money market funds that would be affected by this proposal. We understand, based on interviews with industry representatives, that most money market funds already post portfolio information on their webpages at least quarterly.[325] To be conservative, the staff estimates that 20 percent of money market funds, or 150 funds, do not currently post this information at least quarterly, and therefore would need to develop a webpage to comply with the proposed rule. We estimate that a money market fund would spend approximately 24 hours of internal money market fund staff time initially to develop the webpage. We further estimate that a money market fund would spend approximately 4 hours of professional time to maintain and update the relevant webpage with the required information on a monthly basis. Based on an estimate of 750 money market funds posting their portfolio holdings on their webpages, including 150 funds incurring start-up costs to develop a webpage, we estimate that, in the aggregate, the proposed amendment would result in a total of 37,200 average burden hours for all money market funds for each of the first three years.[326]

3. Reporting of Rule 17a–9 Transactions

We are proposing to amend rule 2a–7 to require a money market fund to promptly notify the Commission by electronic mail of the purchase of a money market fund's portfolio security by an affiliated person in reliance on the rule and to explain the reasons for such purchase.[327] The proposed reporting requirement is designed to assist Commission staff in monitoring money market funds' affiliated transactions that otherwise would be prohibited. The new collection of information would be mandatory for money market funds that rely on rule 2a–7 and that rely on rule 17a–9 for an affiliated person to purchase a money market fund's portfolio security. Information submitted to the Commission related to a rule 17a–9 transaction would not be kept confidential.[328]

We estimate that fund complexes will provide one notice for all money market funds in a particular fund complex holding a distressed security purchased in a transaction under rule 17a–9. As noted above, Commission staff estimates that there are 171 fund complexes with money market funds subject to rule 2a–7. Of these fund complexes, Commission staff estimates that an average of 25 per year would be required to provide notice to the Commission of a rule 17a–9 transaction, with the total annual response per fund

[317] This estimate is based on the following calculation: (21 hours + 3 hours) × 171 fund complexes = 4104 hours.

[318] These estimates are based on the following calculations: (21 + 3) ÷ 3 = 8 hours; 8 × 171 fund complexes = 1368 hours. PRA submissions for approval are made every three years. To estimate an annual burden for a collection of information that occurs one time, the total burden is amortized over the three year period.

[319] This estimate is based on the following calculation: (6 hours (analyst) + 1 hour (board)) × 171 fund complexes = 1197 hours.

[320] These estimates are based on the following calculations: (10 hours + 2 hours + 15 hours) × 6 meetings = 162 hours; 162 hours × 171 fund complexes = 27,702 hours.

[321] Proposed rule 2a–7(c)(11)(vii).

[322] This estimate is based on the following calculation: 0.1667 hours × 6 meetings × 171 fund complexes = 171 hours.

[323] These estimates are based on the following calculations: 8 hours (draft procedures) + 7 hours (revise procedures) + 72 hours (6 reports) + 90 hours (assessments) + 1 hour (record retention) = 178 hours; 1368 hours (draft procedures) + 1197 hours (revise procedures) + 12,312 hours (6 reports) + 15,390 (6 assessments) + 171 hours (record retention) = 30,438 hours.

[324] Proposed rule 2a–7(c)(12).

[325] Certain of the required information is currently maintained by money market funds for regulatory reasons, such as in connection with accounting, tax and disclosure requirements. We understand that the remaining information is retained by funds in the ordinary course of business. Accordingly, for the purposes of our analysis, we do not ascribe any time to producing the required information.

[326] The estimate is based on the following calculations. The staff estimates that 150 funds would require a total of 3600 hours initially to develop a webpage (150 funds × 24 hours per fund = 3600 hours). In addition, each of the 750 funds would require 48 hours per year to update and maintain the webpage, for a total of 36,000 hours per year (4 hours per month × 12 months = 48 hours per year; 48 hours per year × 750 funds = 36,000). The average annual hour burden for each of the first three years would thus equal 37,200 hours ([3600 + (36,000 × 3)] ÷ 3).

[327] *See* proposed rule 2a–7(c)(7)(iii).

[328] Commission rules provide, however, for a procedure under which persons submitting notices under the proposed amendment would be able to request that the information not be disclosed under a Freedom of Information Act request. *See* 17 CFR 200.83.

complex, on average, requiring 1 hour of an in-house attorney's time. Given these estimates, the total annual burden of this proposed amendment to rule 2a–7 for all money market funds would be approximately 25 hours.[329]

4. Total Burden

The currently approved burden for rule 2a–7 is 1,348,000 hours. In a recent renewal submission to OMB, we estimated the collection of information burden for the rule is 310,983 hours. The additional burden hours associated with the proposed amendments to rule 2a–7 would increase the renewal estimate to 378,646 hours annually.[330]

*B. Rule 22e–3*

Proposed rule 22e–3 would permit a money market fund to suspend redemptions and postpone the payment of proceeds pending board-approved liquidation proceedings, provided that the fund notifies the Commission by electronic mail of its decision to do so.[331] The proposed rule is intended to reduce the vulnerability of investors to the harmful effects of a run on a fund, and minimize the potential for disruption to the securities markets. The proposed notification requirement is a collection of information under the PRA, and is designed to assist Commission staff in monitoring a money market fund's suspension of redemptions, which would otherwise be prohibited. Only money market funds that break the buck and begin board-approved liquidation proceedings would be able to rely on the rule. The respondents to this information collection therefore would be money market funds that break the buck and elect to rely on the exemption afforded by the rule. Compliance with the notification requirements of rule 22e–3 would be necessary for money market funds that seek to rely on rule 22e–3 to suspend redemptions and postpone payment of proceeds pending a liquidation, and would not be kept confidential.

We estimate that, on average, one money market fund would break the buck and liquidate every six years.[332] Staff estimates that a fund providing the required electronic mail notice under proposed rule 22e–3 would spend approximately 1 hour of an in-house attorney's time to prepare and submit the notice. Given these estimates, the total annual burden of proposed rule 22e–3 for all money market funds would be approximately 10 minutes.[333]

*C. Monthly Reporting of Portfolio Holdings*

1. Rule 30b1–6 and Form N–MFP

Proposed rule 30b1–6 would require money market funds to file an electronic monthly report on proposed Form N–MFP within two business days after the end of each month. The proposed rule is intended to improve transparency of information about money market funds' portfolio holdings and facilitate oversight of money market funds. The information required by the proposed form would be data-tagged in XML format and filed through EDGAR. The respondents to rule 30b1–6 would be investment companies that are regulated as money market funds under rule 2a–7. Compliance with proposed rule 30b1–6 would be mandatory for any fund that holds itself out as a money market fund in reliance on rule 2a–7. Responses to the disclosure requirements would not be kept confidential.

We estimate that 750 money market funds would be required by rule 30b1–6 to file, on a monthly basis, a complete Form N–MFP disclosing certain information regarding the fund and its portfolio holdings. For purposes of this PRA analysis, the burden associated with the requirements of proposed rule 30b1–6 has been included in the collection of information requirements of proposed Form N–MFP.

Based on our experience with other interactive data filings, we estimate that money market funds would require an average of approximately 40 burden hours to compile, tag and electronically file the required portfolio holdings information for the first time and an average of approximately 8 burden hours in subsequent filings.[334] Based on these estimates, we estimate the average annual burden over a three-year period would be 107 hours per money market fund.[335] Based on an estimate of 750 money market funds submitting Form N–MFP in interactive data format, each incurring 107 hours per year on average, we estimate that, in the aggregate, Form N–MFP would result in 80,250 burden hours, on average, for all money market funds for each of the first three years.

2. Rule 30b1–5 and Form N–Q

Our proposed amendments to rule 30b1–5 would exempt money market funds from the requirement to file a schedule of investments pursuant to Item 1 of Form N–Q. The proposed amendment is intended to eliminate unnecessarily duplicative disclosure requirements. The proposed amendment would only affect investment companies that are regulated as money market funds under rule 2a–7.

We estimate that 750 money market funds would be affected by the proposed amendment to rule 30b1–5. For the purposes of this PRA analysis, the decrease in burden hours resulting from the proposed amendment is reflected in the collection of information requirements for Form N–Q.

We estimate that money market funds would require an average of approximately 4 hours to prepare the schedule of investments required pursuant to Item 1 of Form N–Q. Based on these estimates, we estimate that the average annual burden avoided would be 8 hours per fund.[336] Based on an estimate of 750 money market funds filing Form N–Q, each incurring 8 burden hours per year on average, we estimate that, in the aggregate, our proposed exemption would result in a decrease of 6000 burden hours associated with Form N–Q.[337]

*D. Request for Comments*

We request comment on whether these estimates are reasonable. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii)

---

[329] The estimate is based on the following calculation: (25 fund complexes × 1 hour) = 25 hours.

[330] This estimate is based on the following calculation: 310,983 (estimated in 2a–7 renewal submission) + 30,438 (stress testing) + 37,200 (website posting) + 25 hours (reporting 17a–9 transactions) = 378,646 hours.

[331] *See* proposed rule 22e–3(c).

[332] As discussed above, since the adoption of rule 2a–7 in 1983, only two money market funds have broken the buck.

[333] These estimates are based on the following calculations: (1 hour ÷ 6 years) = 10 minutes per year.

[334] We understand that the required information is currently maintained by money market funds pursuant to other regulatory requirements or in the ordinary course of business. Accordingly, for the purposes of our analysis, we do not ascribe any time to producing the required information.

[335] The staff estimates that a fund would make 36 filings in three years. The first filing would require 40 hours and subsequent filings would require 8 hours each, for an average annual burden of 107 hours (1 filing × 40 hours = 40 hours; 35 filings × 8 hours = 280 hours; 40 hours + 280 hours = 320 hours; 320 hours ÷ 3 years = 107 hours). Thereafter, filers generally would not incur the start-up burdens applicable to the first filing.

[336] Funds are required to file a quarterly report on Form N–Q after the close of the first and third quarters of each fiscal year.

[337] The estimate is based on the following calculation: 750 money market funds × 8 hours per money market fund = 6000 hours.

determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) determine whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements of the proposed amendments should direct them to the Office of Management and Budget, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503, and should send a copy to Elizabeth Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090, with reference to File No. S7–11–09. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this Release; therefore a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this Release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–11–09, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE., Washington, DC 20549–0213.

## V. Cost Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. We have identified certain costs and benefits of the proposed amendments and new rules, and we request comment on all aspects of this cost benefit analysis, including identification and assessment of any costs and benefits not discussed in this analysis. We seek comment and data on the value of the benefits identified. We also welcome comments on the accuracy of the cost estimates in each section of this analysis, and request that commenters provide data that may be relevant to these cost estimates. In addition, we seek estimates and views regarding these costs and benefits for particular covered institutions, including small institutions, as well as any other costs or benefits that may result from the adoption of these proposed amendments and new rules.

### *A. Rule 2a–7*

#### 1. Second Tier Securities, Portfolio Maturity and Liquidity Requirements

We are proposing several changes to the risk-limiting conditions of rule 2a–7. While we believe that these changes would impart substantial benefits to money market funds, we recognize that they also may impose certain costs.

First, we would limit money market fund investments to first tier securities, *i.e.,* securities receiving the highest short-term debt ratings from the requisite NRSROs or securities that the fund's board of directors or its delegate determines are of comparable quality.[338] We also are proposing to limit money market funds to acquiring long-term securities that have received long-term ratings in the highest two ratings categories.[339]

Second, we are proposing certain changes to rule 2a–7's portfolio maturity limits. We are proposing to reduce the maximum weighted average maturity of a money market fund permitted by rule 2a–7 from 90 days to 60 days.[340] We also are proposing a new maturity limitation based on the ''weighted average life'' of fund securities that would limit the portion of a fund's portfolio that could be held in longer term floating- or variable-rate securities. This restriction would require a fund to calculate the weighted average maturity of its portfolio without regard to interest rate reset dates. The weighted average life of a fund's portfolio would be limited to 120 days.[341] Finally, we are proposing to delete a provision in rule 2a–7 that permits money market funds not relying on the amortized cost method of valuation to acquire Government securities with a remaining maturity of up to 762 calendar days. Under the amended rule, money market funds could not acquire any security with a remaining maturity of more than 397 days, subject to the maturity shortening provisions for floating- and variable-rate securities and securities with a Demand Feature.[342]

Third, we are proposing new liquidity requirements on money market funds. Under the proposed amendments, money market funds would be prohibited from acquiring securities unless, at the time acquired, they are liquid, *i.e.,* securities that can be sold or disposed of in the ordinary course of business within seven days at approximately the value ascribed to it by the money market fund.[343] We also propose to limit taxable retail money market funds and taxable institutional money market funds to acquiring Daily Liquid Assets unless five percent of a retail fund's and 10 percent of an institutional fund's assets are Daily Liquid Assets.[344]

In addition, our proposed amendments to rule 2a–7 would impose weekly liquidity requirements on money market funds. Specifically, retail and institutional money market funds would not be permitted to acquire any securities other than weekly liquid assets if, after the acquisition, (i) the retail fund would hold less than 15 percent of its total assets in weekly liquid assets and (ii) the institutional fund would hold less than 30 percent of its total assets in weekly liquid assets.[345] Finally, we are proposing to require that a money market fund at all times hold daily and weekly liquid assets sufficient to meet reasonably foreseeable redemptions in light of its obligations under section 22(e) of the Act and any commitments the fund has made to shareholders.[346]

Our proposed amendments would rely on a money market fund's board of directors to determine, no less frequently than once each calendar year, whether the money market fund is intended to be offered to institutional investors or has the characteristics of a fund that is intended to be offered to institutional investors, based on the: (i) Nature of the record owners of fund shares; (ii) minimum amount required to be invested to establish an account; and (iii) historical cash flows resulting, or expected cash flows that would result, from purchases and redemptions.[347]

##### a. Benefits

We believe that the proposed amendments to rule 2a–7's risk-limiting conditions would be likely to produce broad benefits for money market fund investors. First, they should reduce money market funds' exposure to certain credit, interest rate, and spread risks. For example, precluding money market funds from investing in second tier securities would decrease money market funds' exposure to credit risk. Reducing the maximum weighted average maturity of money market

[338] *See* proposed rule 2a–7(a)(11)(iii); proposed rule 2a–7(a)(11)(iv); proposed rule 2a–7(c)(3).

[339] *See* proposed rule 2a–7(a)(11)(iv)(A).

[340] *See* proposed rule 2a–7(c)(2)(ii).

[341] *See* proposed rule 2a–7(c)(2)(iii).

[342] *See* proposed rule 2a–7(c)(2)(i); rule 2a–7(d)(1)–(5).

[343] *See* proposed rule 2a–7(c)(5)(i).

[344] *See* proposed rule 2a–7(c)(5)(iii). This restriction would not apply to tax exempt money market funds.

[345] *See* proposed rule 2a–7(c)(5)(iv).

[346] *See* proposed rule 2a–7(c)(5)(ii).

[347] *See* proposed rule 2a–7(a)(18) (defining ''Institutional Fund'').

funds' portfolios would further decrease their interest rate sensitivity, as well as reduce their exposure to credit risk. Introducing the weighted average life limitation on money market funds' portfolios would limit credit spread risk and interest rate spread risk to funds from longer term floating- or variable-rate securities.

We expect that the proposed amendments also would bolster the ability of money market funds to maintain a stable net asset value during times when the level of shareholder redemption demand is high. Fund portfolios with a lower weighted average maturity that include a limited amount of longer term floating- or variable-rate securities would turn over more quickly and the fund would be better able to increase its holdings of highly liquid securities in the face of illiquid markets than funds that satisfy current maturity requirements. The proposed liquidity requirements are designed to increase a money market fund's ability to withstand illiquid markets by ensuring that the fund acquires only liquid securities and that a certain percent of its assets are held in daily and weekly liquid assets. These requirements also should decrease the likelihood that a fund would have to realize losses from selling portfolio securities into an illiquid market to satisfy redemption requests. Because the proposed amendments would require a fund to have a contractual right to receive cash for the daily and weekly liquid assets, rather than the current standard, which assumes that a fund would be able to find a buyer for its securities within seven days, we believe that the proposed required liquidity requirements would allow money market fund advisers to more easily adjust the funds' portfolios to increase liquidity when needed.

We believe that a reduction of these credit, interest rate, spread, and liquidity risks would better enable money market funds to weather market turbulence and maintain a stable net asset value per share. The proposed amendments are designed to reduce the risk that a money market fund will break the buck and therefore prevent losses to fund investors. To the extent that money market funds are more stable, they also would reduce systemic risk to the capital markets and provide a more stable source of financing for issuers of short-term credit instruments, thus promoting capital formation. If money market funds become more stable investments as a result of the proposed rule amendments, they may attract further investment, increasing their role as a source of capital formation.

b. Costs

We recognize that there are potential costs that would result if we adopted our proposed changes regarding second tier securities, portfolio maturity, and liquidity. Second tier securities, less liquid securities, and longer term credit instruments typically pay a higher interest rate and, therefore, the proposed amendments may decrease money market funds' yields.

Precluding ownership of second tier securities also may deprive money market funds of some benefits of reduced risk through diversification. We invite comment on whether the benefits of reducing credit risk through precluding purchases of second tier securities justifies the costs of the lost diversification benefits that second tier securities may provide.

If, as a result of the proposed amendments, there is a smaller set of Eligible Securities for a money market fund to choose from, that may increase the cost of those securities if their supply is limited. In particular, to the extent that the proposed liquidity requirements increase demand for highly liquid securities that is not countered by increased supply, the cost of those securities may rise as well. Increased costs of portfolio securities will have a negative impact on money market fund yield. Finally, to the extent that actual investor redemptions are significantly lower than our proposed liquidity requirements, money market funds may achieve lower yields as a result of complying with these liquidity requirements.

Although the impact on individual funds would vary significantly, we estimate that the proposed changes to rule 2a–7's requirements regarding portfolio quality, portfolio maturity, and liquidity would decrease the yield that a money market fund is able to achieve in the range of 2 to 4 basis points. We understand that the majority of money market funds are already in compliance with these proposed requirements due either to their own risk-limiting actions or to their voluntary compliance with the recommendations contained in the ICI Report. Accordingly, we expect that the decrease in yield from these changes to rule 2a–7's risk-limiting conditions would have a relatively minor impact on current money market fund yields.

However, this decreased yield may limit the range of choices that individual money market fund investors currently have to select their desired level of investment risk. This might cause some investors to shift their assets to, among other places, offshore or other enhanced cash funds unregulated by rule 2a–7 that are able to offer a higher yield. Alternatively, some investors may choose to shift their assets to bank deposits. When markets come under stress, investors may be more likely to withdraw their money from these offshore or private funds due to their perceived higher risk [348] and substantial redemptions from those funds and accompanying sales of their portfolio securities could increase systemic risk to short-term credit markets, which would impact money market funds. In addition, the proposed stricter portfolio quality, maturity, and liquidity requirements may result in some money market funds having fewer issuers from which to select securities if some issuers only offer second tier securities, less liquid securities or a larger percentage of longer term securities.

Our proposed portfolio quality, maturity, and liquidity restrictions also may impact issuers. Issuers may experience increased financing costs to the extent that they are unable to find alternative purchasers of their second tier securities, less liquid securities, longer term securities, or floating- and variable-rate securities at previous market rates. As noted earlier in the release, we do not believe that money market funds currently hold a significant amount of second tier securities, or securities that are illiquid at acquisition.[349] Thus, we expect that the proposed amendment's impact on issuers of these securities would be minimal. If the proposed amendments result in companies or governments issuing shorter maturity securities, those issuers may be exposed to an increased risk of insufficient demand for their securities and adverse credit market conditions because they must roll over their short-term financing more frequently. We note that this impact could be mitigated if money market funds sufficiently staggered or ''laddered'' the maturity of the securities in their portfolios. The markets for longer term or floating- and variable-rate securities may become less liquid if the proposed rule amendments cause issuance of these instruments to decline. We generally expect that issuers of floating- or variable-rate securities would respond to the proposed amendments by issuing a greater

[348] During the recent financial crisis, investors redeemed substantial amounts of assets from ultra-short bond funds and certain offshore money market funds. *See* ICI Report, *supra* note 6, at 106–07.

[349] *See supra* note 101 and accompanying and following text, and Section II.C.1.

proportion of their securities with shorter final maturities.

Our proposed requirement that fund boards distinguish between retail and institutional money market funds would require boards to make a determination based on an understanding of the investors in the fund and their behavior. Our proposed liquidity requirements also would require money market funds to ''know their customers,'' including their expected redemption behavior. We expect that most money market funds already have methods to understand their customers and their redemption needs because ''knowing your customer'' is already a best practice. As a result, we also do not expect that these requirements would impose any material costs on funds.

We do not believe that eliminating the provision in rule 2a–7 that allowed money market funds relying solely on the penny-rounding method of pricing to hold Government securities with remaining maturities of up to 762 days would have a material impact on money market funds, investors, or issuers of longer term Government securities because we believe that substantially all money market funds rely on the amortized cost method of valuation, and not exclusively on the penny-rounding method of pricing, and thus are not eligible to rely on this exception.

We request comment on these costs and benefits. Would money market fund investors benefit from the proposed portfolio quality, maturity and liquidity requirements? Would money market funds experience a significant yield and diversification impact from the proposed changes to rule 2a–7's second tier security, portfolio maturity, and liquidity requirements? We note that the highest rated money market funds currently must have a weighted average maturity of 60 days or less, the average weighted average maturity for taxable money market funds as of June 16, 2009 was 53 days, and very few money market funds hold second tier securities.[350] What other impacts would these changes have on money market funds? What effect would such changes have on the short-term credit market and issuers of longer term or debt instruments held to satisfy the daily or weekly liquidity requirements? How would the proposed amendments impact issuers of, and the market for, longer term variable- or floating-rate debt securities? We encourage commenters to provide empirical data to support their analysis.

2. Use of NRSROs

As discussed above, we are considering an approach that would require a money market fund's board of directors to designate NRSROs whose credit ratings the fund would use in determining the eligibility of portfolio securities under rule 2a–7 and that the board would annually determine issue credit ratings that are sufficiently reliable for that use. As we also noted above, we proposed eliminating references to NRSROs in rule 2a–7 last year.[351] For a discussion of the costs and benefits of that proposal, please see Section VI of the NRSRO References Release.[352] Are there additional factors we should consider since that release was published?

We request comment on the approach we are considering. We specifically request comment regarding the standard we are considering for the board's annual determination, *i.e.*, that the designated NRSROs issue ratings that are sufficiently reliable for use in determining the eligibility of portfolio securities. Is this standard appropriate, and if not, what would be a more appropriate standard? We expect that in making their initial designation and their annual determination, fund boards would review a presentation by the fund's adviser regarding the relative strength of relevant NRSROs' ratings and ratings criteria. What kind of guidance, if any, should the Commission provide with respect to such a standard?

According to the ICI Report, a requirement that funds designate three or more NRSROs to use in determining the eligibility of portfolio securities could encourage competition among NRSROs to achieve designation by money market funds.[353] We anticipate that the approach we are considering, which would require fund boards annually to determine that the designated NRSROs issue credit ratings sufficiently reliable to use in determining the eligibility of portfolio securities, may promote competition among NRSROs to produce the most reliable ratings in order to obtain designation by money market funds. In addition to the potential for competition among existing NRSROs, the proposed amendment might encourage new NRSROs that issue ratings specifically for money market fund instruments to enter the market. As we noted above, however, the staff believes it is reasonable to assume that the three NRSROs that issued almost 99 percent of all outstanding ratings across all categories that were issued by the 10 registered NRSROs as of June 2008, also issued well over 90 percent of all outstanding ratings of short term debt.[354] If fund boards were required to designate a minimum of three NRSROs and all money market fund boards chose to designate these three NRSROs, the requirement could result in decreased competition among NRSROs. We request comment on the impact that the approach we are considering, particularly the minimum number of NRSROs, might have on competition among NRSROs. We also request comment on the impact, if any, of this approach with respect to the efficiency of fund managers. Finally, we request comment on any potential benefits this approach might have with respect to money market funds or NRSROs.

We recognize that there could be costs associated with the approach we are considering. Staff estimates that the costs of this approach would include: Initial costs for the board to designate NRSROs, as well as an annual cost to determine that designated NRSROs continue to issue ratings that are sufficiently reliable for use in determining the eligibility of portfolio securities. We expect that fund advisers currently evaluate the strength of NRSRO ratings and ratings criteria as part of the analysis they perform (under delegated authority from the board) in determining the eligibility of portfolio securities, and that this evaluation includes consideration of whether an NRSRO's rating is sufficient for that use. Accordingly, we anticipate that fund advisers would not incur additional time to perform an evaluation that would be the basis for their recommendations to the board when it makes its initial designation and annual determination, but the adviser would incur costs to draft those recommendations in a presentation or report for board review.

Under the current rule, if a money market fund invests in unrated or second tier securities, the adviser must monitor all NRSROs in case an unrated or second tier security has received a rating from any NRSRO below the second highest short-term rating category.[355] Because fund advisers currently monitor NRSROs, we do not expect that limiting the number of NRSROs that a fund would have to monitor to a number designated by the fund board would result in increased

[350] *See supra* text accompanying note 101, note 145 and accompanying text, and note 147.

[351] *See* NRSRO References Proposal, *supra* note 105.

[352] *See id.*

[353] *See* ICI Report, *supra* note 6, at 82.

[354] *See supra* note 116 and accompanying text.

[355] *See* rule 2a–7(c)(6)(i)(A)(2).

costs to fund advisers to monitor NRSROs.

We request comment on our analysis of the potential costs and benefits of a requirement to designate NRSROs. Do funds currently evaluate NRSRO ratings for reliability? Would there be benefits to funds and their advisers if the board designates three or more NRSROs? Would fund advisers benefit from having fewer NRSROs to monitor? Would fund advisers incur significant costs to make presentations to the board recommending which NRSROs to designate? What would be involved, including specific costs, for fund management to evaluate whether an NRSRO ''issues credit ratings that are sufficiently reliable'' for the fund's determination of whether a security is an eligible security? Would funds incur costs if we required them to disclose designated NRSROs in the statement of additional information?

We do not anticipate that the designation of NRSROs would have an adverse impact on capital formation. We request comment on whether requiring fund boards to designate NRSROs would have an impact on capital formation.

3. Stress Testing

We are proposing to require that money market fund boards of directors adopt written procedures that provide for the periodic stress testing of each money market fund's portfolio.[356] The procedures would require testing of the fund's ability to maintain a stable net asset value per share based upon certain hypothetical events.[357] The procedures also would have to provide for a report to be delivered to the fund's board of directors at its next regularly scheduled meeting on the results of the testing and 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.[358]

We anticipate that stress testing would give fund advisers a better understanding of the effect of potential market events and shareholder redemptions on their funds' ability to maintain a stable net asset value, the fund's exposure to the risk that it would break the buck, and actions the adviser may need to take to mitigate the possibility of the fund breaking the buck. We believe that many funds currently conduct stress testing as a matter of routine fund management and business practice. We anticipate, however, that funds that do not currently perform stress testing and funds that may revise their procedures in light of the proposed rule amendments would give their managers a tool to better manage those risks. For fund boards of directors that do not currently receive stress test results, we believe that the regular reports and assessments would provide money market fund boards a better understanding of the risks to which the fund is exposed.

We understand that today rigorous stress testing is a best practice followed by many money market funds.[359] We understand that the fund complexes that conduct stress tests include smaller complexes that offer money market funds externally managed by advisers experienced in this area of management.[360] Accordingly, staff estimates that as a result of the proposed amendments to adopt stress testing procedures, (i) funds that currently conduct rigorous stress testing, including tests for hypothetical events listed in the proposed amendment (and concurrent occurrences of those events) would incur some cost to evaluate whether their current test procedures would comply with the proposed rule amendment, but would be likely to incur relatively few costs to revise those procedures or continue the stress testing they currently perform, (ii) funds that conduct less rigorous stress testing, or that do not test for all the hypothetical events listed in the proposed rule amendment, would incur somewhat greater expenses to revise those procedures in light of the proposed amendments and maintain the revised testing, and (iii) funds that do not conduct stress testing would incur costs to develop and adopt stress test procedures and conduct stress tests. As noted above, we believe that there is a range in the extent and rigor of stress testing currently performed by money market funds. We also expect that stress test procedures are or would be developed by the adviser to a fund complex for all money market funds in the complex while specific stress tests are performed for each individual money market fund. We estimate that a fund complex that currently does not conduct stress testing would require approximately 1 month for 2 risk management analysts and 2 systems analysts to develop stress test procedures at a cost of approximately $155,000, 21 hours for a risk management analyst to draft the procedures, and 3 hours of board of directors' time to adopt the procedures for a total of approximately $173,000.[361] Costs for fund complexes that would have to revise or fine-tune their stress test procedures would be less. For purposes of this cost benefit analysis, we estimate that these funds would incur half the costs of development, for a total of approximately $95,000.[362] Funds that would not have to change their test procedures would incur approximately $20,000 to determine compliance with the proposed amendment, and to draft and adopt the procedures.[363] We also would anticipate that if there is a demand to develop stress testing procedures, third parties may develop programs that funds could purchase for less than our estimated cost to develop the programs themselves.

As with the development of stress test procedures, the costs funds would incur each year as a result of the proposed amendments to update test procedures, conduct stress tests and provide reports on the tests and assessments to the board of directors would vary. Funds that currently conduct stress tests already incur costs to perform the tests. In addition, some of those funds may currently provide reports to senior management (if not the board) of their

[356] Proposed rule 2a–7(c)(8)(ii)(D).

[357] The proposed provision includes as hypothetical events a change in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on a portfolio security, and widening or narrowing of spreads between yields on a benchmark selected by the fund and securities held by the fund. *See* proposed rule 2a–7(c)(8)(ii)(D)(*1*).

[358] Proposed rule 2a–7(c)(8)(ii)(D)(*2*), (*3*). The report must include dates on which the testing was performed and the magnitude of each hypothetical event that would cause the deviation of the money market fund's net asset value calculated using available market quotations (or appropriate substitutes that reflect current market conditions) from its net asset value per share, calculated using amortized cost, to exceed ½ of 1%.

[359] As noted above, the ratings agencies stress test the portfolios of money market funds they rate. In addition, the Irish Financial Services Authority requires stress testing of money market funds domiciled in Ireland, and the Institutional Money Market Funds Association provides guidance for its members in stress testing money market fund portfolios. *See supra* notes 214–215 and accompanying text.

[360] These complexes do not, however, meet the definition of ''small entities'' under the Investment Company Act for purposes of the Regulatory Flexibility Act of 1980. 5 U.S.C. 603(a). *See infra* note 417.

[361] This estimate is based on the following calculations: $275/hour × 280 hours (2 senior risk management specialists) + ($244/hour × 320 hours (2 senior systems analysts) = $155,080; $275/hour (1 senior risk management specialist) × 21 hours = $5775; $4000/hour × 3 hours = $12,000; $155,080 + $5775 + $12,000 = $172,855.

[362] This estimate is based on the following calculation: (155,080 × 0.5) (revise procedures) + $5775 (draft procedures) + $12,000 (board approval) = $93,315.

[363] This estimate is based on the following calculation: $275/hour (senior risk management specialist) × 8 hours = $2200; $2200 + $5775 + $12,000 = $19,975.

test results. We assume, however, that few, if any, fund advisers provide a regular assessment to the board of the fund's ability to withstand the events reasonably likely to occur in the following year. For that reason, we estimate that all fund complexes would incur costs of $3000 to provide a written report on the test results to the board, $4000 to provide an assessment to the board and $10 to retain records of the reports and assessments for a total annual cost to a fund complex of approximately $42,000.[364] We estimate that a portion of funds would incur additional costs each year to perform stress tests and update their procedures each year, up to a maximum of approximately $113,000.[365]

For purposes of this cost benefit analysis, Commission staff has estimated that 25 percent of fund complexes (or 43 complexes) would have to develop stress test procedures, 50 percent (or 85) would have stress test procedures, but have to revise those procedures, and 25 percent of complexes (or 43 complexes) would review the procedures without having to change them. Based on these estimates, staff further estimates that the total one time costs for fund complexes to develop or refine existing stress test procedures would be approximately $19 million.[366] In addition, staff estimates that the annual costs to all funds to conduct stress tests, update test procedures, provide reports and assessments to fund boards and retain records of the reports and assessments would be approximately $17 million.[367]

We request comment on our estimates. We are particularly interested in comments regarding how many funds currently conduct stress testing, the extent and nature of that testing, including whether the procedures can be adopted on a complex wide basis, and the costs to develop rigorous stress testing procedures. For those money market funds that have stress test procedures, how significantly would they have to change those procedures in light of the proposed rule amendment? What costs would they incur, including specific costs for personnel that would be involved in changes?

4. Repurchase Agreements

We are proposing to modify the conditions under which a money market fund may treat the acquisition of a repurchase agreement collateralized fully to be an acquisition of the repurchase agreement's collateral for purposes of rule 2a–7's diversification requirement.[368] Money market funds would be able to adopt this ''look-through'' treatment only with respect to repurchase agreements collateralized by cash items or Government securities[369] and as to which the board of directors or its delegate has evaluated the creditworthiness of the counterparty.[370]

We believe that the proposed changes would limit money market funds' exposure to credit risk. Collateral other than cash items and Government securities might not adequately protect money market funds because the funds may be unable to liquidate the collateral without incurring a loss if the counterparty defaults. The creditworthiness evaluation, moreover, would make it less likely that a money market fund enters into repurchase agreements with counterparties that will default and be exposed to risks related to the collateral. As discussed above, we believe that the reduction of credit risk would better enable money market funds to weather market turbulence and maintain a stable net asset value per share.

We recognize that these proposed changes could result in costs to money market funds. The limitation on money market funds' ability to invest in repurchase agreements collateralized with securities other than cash items and Government securities may result in lower yields for money market funds to the extent that other investment opportunities do not provide the same returns as those agreements. The limitation also could lead to an increase in the counterparties' short-term financing costs. Counterparties may have to substitute such repurchase agreements with other sources of financing linked to the same type of collateral. If counterparties limited their own investments in securities that are no longer permissible collateral, the issuers of such securities could also be indirectly affected by our proposed change. The restrictions on repurchase agreements held by money market funds might potentially affect the functioning of these important markets. We invite comment on what effects, if any, these restrictions might have on the markets for repurchase agreements.

The creditworthiness evaluation would also impose additional costs. A credit risk evaluation, however, is required with respect to other portfolio securities and to repurchase agreements for which money market funds do not adopt a look-through treatment.[371] We understand, moreover, that many money market fund complexes already perform a creditworthiness evaluation for all repurchase agreement counterparties. Accordingly, we believe that the additional cost imposed on money market funds, if any, would be minimal.

We request comment on any potential costs and benefits. Would the proposed amendments significantly reduce the risk that money market funds incur losses upon the default of their repurchase agreement counterparties? What effect would the limitation on permissible collateral have on counterparties' ability to obtain short-term financing? How would the proposed change impact issuers of securities that would no longer be permissible collateral? Would the required creditworthiness evaluation impose any material cost on money market funds? We encourage commenters to provide empirical data to support their analysis.

5. Public Web site Posting

The proposed amendments to rule 2a–7 would require money market funds to post monthly portfolio information on their Web sites.[372] The rule is intended to provide shareholders with timely information about the securities held by the money market fund.

We anticipate that the proposal to require funds to post monthly portfolio information on their Web sites would benefit investors by providing them a better understanding of their own risk exposure and thus enabling them to make better informed investment decisions. The proposed rule may thus

[364] This estimate is based on the following calculation: *Report:* $275/hour × 10 hours (senior risk management specialist) + $62 × 2 hours (administrative assistant) = $2874; *Assessment:* $275/hour × 15 hours (senior risk management specialist) = $4125; *Record retention:* $62/hour × 0.1667 hours (administrative assistant) = $10.33; ($2874 + $4125 + $10) × 6 (board meetings per year) = $42,054.

[365] This estimate is based on the following calculations: *Tests:* $275/hour × 15 hours (senior risk management specialist) + $244/hour × 20 hours (senior systems analyst) = $9,005; $9,005 × 12 (monthly testing) = $108,060; *Update procedures:* $275/hour × 5 hours (senior risk management specialist) + $4000/hour × 1 hour = $5375; $108,060 + $5375 = $113,435.

[366] This estimate is based on the following calculation: (43 × $173,000) + (85 × $95,000) + (43 × $20,000) + (171 × $5775) + (171 × $12,000) = $19,413,525.

[367] This estimate is based on the following calculation: (43 × $113,000) + (85 × $113,000 × 0.5) + (171 × $42,054 (reports and assessments)) = $16,852,734.

[368] *See* rule 2a–7(c)(4)(ii)(A). The rule 5b–3(c)(1) definition of collateralized fully, which is cross-referenced by rule 2a–7(a)(5), sets forth the related conditions. Under the current definition, a money market fund may look through repurchase agreements collateralized with cash items, Government securities, securities with the highest rating or unrated securities of comparable credit quality.

[369] Proposed rule 2a–7(a)(5).

[370] Proposed rule 2a–7(c)(4)(ii)(A).

[371] *See* rule 2a–7(c)(3)(i).

[372] Proposed rule 2a–7(c)(12).

instill more discipline into portfolio management and reduce the likelihood of a money market fund breaking the buck. Finally, any increased costs to money market funds from monthly reporting may be offset to a degree by the proposal to exclude them from current requirements to file quarterly portfolio holdings information on Form N–Q. For the purposes of the PRA analysis, we estimate that money market funds would realize, in the aggregate, a decrease of 6,000 burden hours, or $470,880, from this exclusion.[373]

The proposed website posting requirement would also impose certain costs on funds. We estimate that, for the purposes of the PRA, money market funds would be required to spend 24 hours of internal money market fund staff time initially to develop a webpage, at a cost of $4944 per fund.[374] We also estimate that all money market funds would be required to spend 4 hours of professional time to maintain and update the webpage each month, at a total annual cost of $9888 per fund.[375] We believe, however, that our estimates may overstate the actual costs that would be incurred to comply with the website posting requirement because many funds currently post their portfolio holdings on a monthly, or more frequent, basis.[376] For purposes of this cost benefit analysis, Commission staff estimates that 20 percent of money market portfolios (150 portfolios) do not currently post portfolio holdings information on their websites. Based on these estimates, we estimate that the total initial costs for the proposed website disclosure would be $741,600.[377] In addition, we estimate that the annual costs for all money market funds to maintain and update their webpages would be $7.4 million.[378]

In addition, monthly website disclosure may impose other costs on funds and their shareholders. For example, more frequent disclosure of portfolio holdings may arguably expand the opportunities for professional traders to exploit this information by engaging in predatory trading practices, such as front-running. However, given the short-term nature of money market fund investments and the restricted universe of eligible portfolio securities, we believe that the risk of trading ahead is severely curtailed in the context of money market funds.[379] For similar reasons, we believe that the potential for ''free riding'' on a money market fund's investment strategies, *i.e.,* obtaining for free the benefits of fund research and investment strategies, is minimal. Given that shares of money market funds are ordinarily purchased and redeemed at the stable price per share, we believe that there would be relatively few opportunities for profitable arbitrage. Thus, we estimate that the costs of predatory trading practices under this proposal would be minimal. We request comment on the analysis above, and on any other potential costs and benefits of the proposed website disclosure requirement.

6. Processing of Transactions

Our proposal would require that a money market fund's board determine in good faith, on an annual basis, that the fund (or its transfer agent) has the capacity to redeem and sell securities at prices that do not correspond to the fund's stable net asset value per share.[380] As discussed above, the aftermath of 2008 market events revealed that some funds had not implemented systems to calculate redemptions at prices other than the funds' stable net asset value per share.[381] Because of this failure, transactions were processed manually, which extended the time that investors had to wait for the proceeds from their redeemed shares.

As noted in Section II.G above, money market funds may be required to process transactions at a price other than the fund's stable share price and pay the proceeds of redemptions within seven days (or a shorter time that the fund has represented). We believe that funds that do not have the operational capacity to price shares at other than the stable share price risk being unable to meet their obligations under the Act. We expect that the proposed amendments would help eliminate the risk that money market funds would not be able to meet these obligations in the event the fund breaks a buck. Shareholders would benefit from the proposed amendments because they would be more likely to receive the proceeds from their investments in the event of a liquidation.

Because funds are obligated to redeem at other than stable net asset value per share, there should be no new cost associated with the requirement for the funds (or their transfer agents) to have the systems that can meet these requirements. To the extent that funds and transfer agents have to change their systems, however, these changes will likely entail costs. If a fund complex were to require one month of a senior systems analyst's time in assuring that the required systems are in place, the total cost for the fund complex would be $39,040.[382] Based on this estimate we estimate that, if one-third of the fund complexes are not currently able to redeem at prices other than stable net asset value, the total cost to all money market funds would be $2,225,280.[383] We also anticipate that the board's determination would result in costs. We anticipate that the board's determination would be based on a review at a regularly scheduled board meeting of the fund adviser's or the transfer agent's certification that the operational systems have the requisite capacity. Commission staff estimates that this review would take about 15 minutes of board time at a cost of $1000.[384] Based on this estimate we estimate that the total cost to all money market funds of board determinations would be $171,000.[385] We request comment on the analysis above, and on any other potential costs and benefits of this proposed rule amendment.

*B. Rule 17a–9*

The Commission is proposing to amend rule 17a–9 to expand the circumstances under which affiliated persons can purchase money market fund portfolio securities. Under the proposed amendment, a money market fund could sell a portfolio security that has defaulted (other than an immaterial default unrelated to the financial condition of the issuer) to an affiliated person for the greater of the security's amortized cost value or market value (plus accrued and unpaid interest), even though the security continued to be an eligible security.[386]

The proposed amendment essentially would codify past Commission staff no-

[373] This estimate is based on our experience with other filings and an estimated hourly wage rate of $78.48 (6000 hours × $78.48 = $470,880).

[374] The staff estimates that a webmaster at a money market fund would require 24 hours (at $206 per hour) to develop and review the webpage (24 hours × $206 = $4944).

[375] The staff estimates that a webmaster would require 4 hours (at $206 per hour) to maintain and update the relevant webpages on a monthly basis (4 hours × $206 × 12 months = $9888).

[376] *See supra* note 325 and accompanying text.

[377] This calculation is based on the following estimate: ($4944 × 150 portfolios) = $741,600.

[378] This calculation is based on the following estimate: ($9888 × 750 portfolios) = $7,416,000.

[379] *See* ICI Report, *supra* note 6, at 93.

[380] Proposed rule 2a–7(c)(1).

[381] *See supra* note 262 and accompanying text.

[382] This estimate is based on the following calculation: $244/hour × 160 hours (senior systems analyst) = $39,040.

[383] This is based on the following calculation: (171 (fund complexes) ÷ 3) × $39,040 = $2,225,280.

[384] This is based on the following calculation: $4000/hour (board time) × 0.25 hours = $1000.

[385] This is based on the following calculation: $1000 × 171 (fund complexes) = $171,000.

[386] *See* proposed rule 17a–9(a).

action letters[387] and should benefit investors by enabling money market funds to dispose of troubled securities (*e.g.,* securities depressed in value as a result of market conditions) from their portfolios quickly without any loss to fund shareholders. It also would benefit money market funds by eliminating the cost and delay of requesting no-action assurances in these scenarios and the uncertainty whether such assurances will be granted.[388] We do not believe that there are any costs associated with this amendment, but we request comment on this analysis.

In addition, we are proposing to permit affiliated persons to purchase other portfolio securities from an affiliated money market fund, for any reason, provided that such person would be required to promptly remit to the fund any profit it realizes from the later sale of the security.[389] Our staff provided temporary no-action assurances last fall to certain funds facing extraordinary levels of redemption requests for affiliated persons of such funds to purchase eligible securities from the funds at the greater of amortized cost or market value (plus accrued and unpaid interest).[390] In these circumstances, money market funds may need to obtain cash quickly to avoid selling securities into the market at fire sale prices to meet shareholder redemption requests, to the detriment of remaining shareholders. The staff also provided no-action assurances to money market funds last fall for affiliated persons of the fund to purchase at the greater of amortized cost or market value (plus accrued and unpaid interest) certain distressed securities that were depressed in value due to market conditions potentially threatening the stable share price of the fund, but that remained eligible securities and had not defaulted.[391] Money market funds and their shareholders would benefit if affiliated persons were able to purchase securities from the fund at the greater of amortized cost or market value (plus accrued and unpaid interest) in such circumstances without the time, expense, and uncertainty of applying to Commission staff for no-action assurances.

Affiliated persons purchasing such securities would have costs in creating and implementing a system for tracking the purchased securities and remitting to the money market fund any profit ultimately received as a result. We estimate that creating such a system on average would require 5 hours of a senior programmer's time, at a cost of $1460 for each of the 171 fund complexes with money market funds and a total cost of $249,660.[392] After the initial creation of this system, we expect that the time spent noting in this system that a security was purchased under rule 17a–9 would require a negligible amount of compliance personnel's time. Based on our experience, we do not anticipate that there would be many instances, if any, in which an affiliated person would be required to repay profits in excess of the purchase price paid to the fund. However, if there is a payment, it would be made to the fund. If the payment is sufficiently large, we believe that funds are likely to include it with the next distribution to shareholders, which would not result in any additional costs to the fund. We request comment on this analysis. Are our cost estimates accurate? Are there other costs in allowing an affiliated person of a money market fund to purchase portfolio securities from the fund? Are there incentives that might encourage an affiliated person to purchase securities that are not distressed in any way? If so, would such purchases result in any cost to the fund and its investors?

The Commission also is proposing a related amendment to rule 2a–7, which would require that funds report all transactions under rule 17a–9 to the Commission. We believe that this reporting requirement would benefit fund investors by allowing the Commission to monitor the purchases for possible abuses and conflicts of interest on the part of the affiliates. It also would allow the Commission to observe what types of securities are distressed and which money market funds are holding distressed securities or are subject to significant redemption pressures. This information would better enable the Commission to monitor emerging risks at money market funds. For purposes of the Paperwork Reduction Act analysis, we estimate this amendment would impose relatively small reporting costs on money market funds of $7625 per year.[393] We request comment on whether these cost estimates are reasonable. We also request comment on our analysis of the costs and benefits of this proposed rule amendment.

*C. Rule 22e–3*

Proposed rule 22e–3 would permit money market funds that break the buck to suspend redemptions and postpone payment of proceeds pending board-approved liquidations. The rule would thus facilitate orderly liquidations, which would protect value for fund shareholders and minimize disruption to financial markets. The rule would also enable funds to avoid the expense and delay of obtaining an exemptive order from the Commission, which we estimate would otherwise cost about $75,000,[394] and would provide legal certainty to funds that wish to suspend redemptions during a liquidation in the interest of fairness to all shareholders.

Proposed rule 22e–3 would impose certain minimal costs on funds relying on the rule by requiring them to provide prior notice to the Commission of their decision to suspend redemptions in connection with a liquidation. We estimate that, for the purposes of the PRA, the annual burden of the notification requirement would be 10 minutes for a cost of $51.[395] The proposed rule may also impose costs on shareholders who seek to redeem their shares, but are unable to do so. In those circumstances, shareholders might have to borrow funds from another source, and thereby incur interest charges and other transactional fees. We believe the potential costs associated with proposed rule 22e–3 would be minimal, however, because the proposed rule would provide a limited exemption that is only triggered in the event of a fund breaking the buck and liquidating. We request comment on this analysis, and on any other potential costs and benefits of proposed rule 22e–3.

*D. Rule 30b1–6 and Form N–MFP: Monthly Reporting of Portfolio Holdings*

Proposed rule 30b1–6 and Form N–MFP would require money market funds to file with the Commission interactive data-formatted portfolio holdings information on a monthly basis. We expect that the proposed rule would

[387] *See supra* Section II.H.1.

[388] Commission staff estimates that the costs to obtain staff no-action assurances range from $50,000 to $100,000.

[389] *See* proposed rule 17a–9(b)(2).

[390] Many of the no-action letters can be found on our website. *See http://www.sec.gov/divisions/investment/im-noaction.shtml#money*.

[391] *Id.*

[392] This estimate is based on the following calculation: $292/hour × 5 hours × 171 fund complexes = $249,660.

[393] This estimate is based on the following calculations: 25 (notices) + $305/hour (attorney) × 1 hour = $7625. *See supra* note 329 and accompanying text.

[394] *See* Exchange Traded Funds, Investment Company Act Release No. 28913 (Mar. 11, 2008) [73 FR 14618 (Mar. 18, 2008)] at n.301 (estimating a cost range between $75,000 and $350,000 to submit an application for relief to operate an ETF). We assume that the costs associated with an application for exemptive relief from section 22(e) would be on the low end of this range because section 22(e) exemptive applications are often less involved than ETF exemptive applications.

[395] This estimate is based on the following calculation: $305/hour × 1 ÷ 6 hour = $51.

improve the efficiency and effectiveness of the Commission's oversight of money market funds by enabling Commission staff to manage and analyze money market fund portfolio information more quickly and at a lower cost than is currently possible. The interactive data would also facilitate the flow of information between money market funds and other users of this information, such as information services, academics, and investors. As the development of software products to analyze the data continues to grow, we expect these benefits would increase.

Money market funds may also realize cost savings from the proposed rule. Currently, money market funds provide portfolio holdings information in a variety of formats to different third-parties, such as information services and NRSROs. The proposed rule may encourage the industry to adopt a standardized format, thereby reducing the burdens on money market funds of having to produce this information in multiple formats. In addition, money market funds may also benefit from cost savings to the extent that we exempt them from filing certain information required to be disclosed in existing quarterly portfolio holdings reports.

The proposed reporting requirement would also impose certain costs. We estimate that, for the purposes of the PRA, these filing requirements (including collecting, tagging, and electronically filing the report) would impose 128 burden hours at a cost of $35,968 [396] per money market fund for the first year, and 96 burden hours at a cost of $26,976 [397] per money market fund in subsequent years.[398]

For the reasons outlined in the discussion on the monthly website posting requirement, we estimate that there would be minimal additional costs incurred in connection with the proposed reporting requirement. We request comment on our estimates, including whether our assumptions about the costs and benefits are correct. We also request comment on other potential costs and benefits of the proposed reporting requirement.

*E. Request for Comments*

The Commission requests comment on the potential costs and benefits of the proposed rules and rule amendments. We also request comment on the potential costs and benefits of any alternatives suggested by commenters. We encourage commenters to identify, discuss, analyze, and supply relevant data regarding any additional costs and benefits. For purposes of the Small Business Regulatory Enforcement Act of 1996,[399] the Commission also requests information regarding the potential annual effect of the proposals on the U.S. economy. Commenters are requested to provide empirical data to support their views.

## VI. Competition, Efficiency and Capital Formation

Section 2(c) of the Investment Company Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is consistent with the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[400]

*A. Rule 2a–7*

1. Second Tier Securities, Portfolio Maturity, and Liquidity Limits

We are proposing several amendments to rule 2a–7 to tighten the risk-limiting conditions of the rule. We are proposing to limit money market fund investments to only first tier securities, *i.e.,* securities receiving the highest short-term ratings from the requisite NRSROs or unrated securities that the fund's board of directors or its delegate determines are of comparable quality.[401] We also are proposing to limit money market funds to acquiring long-term securities that have received long-term ratings in the highest two ratings categories.[402]

The proposed amendments would reduce the maximum weighted average maturity of a money market fund permitted by rule 2a–7 from 90 days to 60 days.[403] They also would impose a new maturity limitation based on the weighted average ''life'' of fund securities that would limit the portion of a fund's portfolio that could be held in longer term floating- or variable-rate securities.[404] We are proposing to delete a provision in rule 2a–7 that permits money market funds not relying on the amortized cost method of valuation to acquire Government securities with a remaining maturity of up to 762 calendar days.

Finally, we are proposing new liquidity requirements on money market funds. Under the proposed amendments, money market funds would be prohibited from acquiring illiquid securities[405] and money market funds would be required to comply with certain minimum daily and weekly liquidity requirements.[406] The amended rule also would require that a money market fund at all times hold highly liquid securities sufficient to meet reasonably foreseeable redemptions in light of its obligations under section 22(e) of the Act and any commitments the fund has made to shareholders.[407]

We believe that these changes would reduce money market funds' sensitivity to interest rate, credit, and liquidity risks. These changes also would limit the credit spread risk and interest rate spread risk produced by longer term securities. A reduction of these risks would better enable money market funds to weather market turbulence and maintain a stable net asset value per share. We believe that the changes would reduce the risk that a money market fund will break the buck and therefore prevent losses to fund investors. To the extent that money market funds are more stable, the changes also would reduce systemic risk to the capital markets and ensure a stable source of financing for issuers of short-term credit instruments. We believe that these effects would encourage capital formation by encouraging investment in money market funds, thereby allowing them to expand as a source of short-term financing in the capital markets.

These changes also may reduce maturities of short-term credit securities that issuers offer, which may increase financing costs for these issuers who might have to go back more frequently to the market for financing. To the extent that some issuers are unwilling or unable to issue securities that match money market fund demand given these proposed restrictions, the amendments could have a negative impact on capital formation.

If the proposed amendments reduce yields that money market funds are able to offer, some investors may move their money to, among other places, offshore unregulated money market funds that do not follow rule 2a–7's strictures and

[396] This estimate is based on the following calculation: $281/hour × 128 hours (senior database administrator) = $35,968.

[397] This estimate is based on the following calculation: $281/hour × 96 hours (senior database administrator) = $26,976.

[398] We understand that some money market funds may outsource all or a portion of these responsibilities to a filing agent, software consultant, or other third-party service provider. We believe, however, that a fund would engage third-party service providers only if the external costs were comparable, or less than, the estimated internal costs of compiling, tagging, and filing the Form N–MFP.

[399] Pub. L. 104–121, Title II, 110 Stat. 857 (1996).

[400] 15 U.S.C. 80a–2(c).

[401] *See* proposed rule 2a–7(a)(11)(iii); proposed rule 2a–7(a)(11)(iv).

[402] *See* proposed rule 2a–7(a)(11)(iv)(A).

[403] *See* proposed rule 2a–7(c)(2)(ii).

[404] *See* proposed rule 2a–7(c)(2)(iii).

[405] *See* proposed rule 2a–7(c)(5)(i).

[406] *See* proposed rule 2a–7(c)(5).

[407] *See* proposed rule 2a–7(c)(5)(ii).

thus are able to offer a higher yield. Beyond the competitive impact, such a change could increase systemic risks to short-term credit markets and capital formation by increasing investment in less stable short-term instruments.

Precluding ownership of second tier securities also may have anticompetitive effects on some relatively small money market funds that may compete with larger funds on the basis of yield. The proposed elimination of the ability of money market funds to invest in second tier securities may affect the capital raising ability and strategies of the issuers of second tier securities or otherwise affect their financing arrangements, and may affect the flexibility of investing options for funds. As noted above, however, second tier securities represent only a very small percentage of money market fund portfolios today, which suggests that our proposed amendments would not have a material effect on capital formation. We solicit specific comment on whether the proposed amendments regarding second tier securities would promote efficiency, competition and capital formation.

2. Stress Testing

We are proposing to amend rule 2a–7 to require the board of directors of each money market fund to adopt procedures providing for periodic stress testing of the money market fund's portfolio, reporting the results of the testing to fund boards, and providing an assessment to the board.[408] We believe that stress testing could increase the efficiency of money market funds by enhancing their risk management and thus making it more likely that the fund will be better prepared for potential stress on the fund due to market events or shareholder behavior. Money market funds may become more stable as a result of the risk management benefits provided by stress testing, allowing them to expand and attract further investment. If so, this result will promote capital formation. We do not believe that stress testing would have an adverse impact on competition or capital formation. What effect would the proposed requirement have on competition, efficiency and capital formation?

3. Repurchase Agreements

We are proposing to allow money market funds to treat the acquisition of a repurchase agreement to be an acquisition of the collateral for purposes of rule 2a–7's diversification requirement only if the repurchase agreement is collateralized by cash items or Government securities[409] and after the board of directors or its delegate has evaluated the creditworthiness of the counterparty.[410]

We believe that these changes would limit money market funds' exposure to credit risk. The reduction of credit risk would increase money market funds' ability to maintain a stable net asset value per share, thereby preventing losses to fund investors, reducing systemic risk to the capital markets and ensuring a stable source of financing for issuers of short-term credit instruments. More stable money market funds may attract greater investments, thus promoting capital formation and providing a greater source of short-term financing in the capital markets.

The limitation on money market funds' ability to invest in repurchase agreements collateralized with securities other than cash items and Government securities may result in an increase in the short-term financing costs of the counterparties in such agreements, thereby reducing their willingness to invest in those securities. As a result, issuers of such securities could also be indirectly affected by our proposed change, which therefore could have a negative impact on capital formation. We request comment on what effect the proposed amendments would have on competition, efficiency, and capital formation.

4. Public Web Site Disclosure

We are proposing to require money market funds to disclose certain portfolio holdings information on their Web sites on a monthly basis.[411] The proposed rule amendment would provide greater transparency of the fund's investments for current and prospective shareholders, and may thus promote more efficient allocation of investments by investors. We believe the proposed rule amendment may also improve competition, as better-informed investors may prompt funds managers to provide better services and products. We do not anticipate that funds would be disadvantaged, with respect to competition, because so many already have chosen to provide the information more frequently than monthly. In addition, the investments selected by money market funds are less likely than, for example, equity funds, to be investments from which competing funds would obtain benefit by scrutinizing on a monthly basis. The proposed rule may also promote capital formation by making portfolio holdings information readily accessible to investors, who may thus be more inclined to allocate their investments in a particular fund or in money market funds instead of an alternative product. Alternatively, the proposed rule could have the reverse effect if the portfolio holdings information makes investors less confident regarding the risks associated with money market funds, including the risk that market participants may use the information obtained through the disclosures to the detriment of the fund and its investors, such as by trading along with the fund or ahead of the fund by anticipating future transactions based on past transactions. We request comment on what effect this proposed rule would have on competition, efficiency, and capital formation.

5. Processing of Transactions

We are proposing to require that each money market fund's board determine, at least once each calendar year, that the fund has the capability to redeem and sell its securities at prices other than the fund's stable net asset value per share.[412] This amendment would require money funds to have the operational capacity if they break the buck to continue to process investor transactions in an orderly manner. This amendment would increase efficiency at money market funds that break the buck by increasing the speed and minimizing the operational difficulties in satisfying shareholder redemption requests in such circumstances. It may also reduce investors' concerns that redemption would be unduly delayed if a money market fund were to break the buck. We do not believe that this amendment would have a material impact on competition or capital formation. We request comment on what effect this proposed amendment would have on competition, efficiency, and capital formation.

*B. Rule 17a–9*

The Commission is proposing to amend rule 17a–9 to expand the circumstances under which affiliated persons can purchase money market fund securities. Under the proposed amendments, a money market fund could sell a portfolio security that has defaulted (other than an immaterial default unrelated to the financial condition of the issuer) to an affiliated person for the greater of the security's amortized cost value or market value (plus accrued and unpaid interest), even though the security continued to be an

[408] Proposed rule 2a–7(c)(8)(ii)(D).

[409] Proposed rule 2a–7(a)(5).

[410] Proposed rule 2a–7(c)(4)(ii)(A).

[411] *See supra* Section II.F.1.

[412] Proposed rule 2a–7(c)(1).

eligible security.[413] In addition, the proposed amendment would permit affiliated persons, for any reason, to purchase other portfolio securities from an affiliated money market fund on the same terms provided that such person is required to promptly remit to the fund any profit it realizes from the later sale of the security.[414] These amendments would increase the efficiency of both the Commission and money market funds by allowing affiliated persons to purchase portfolio securities from money market funds under distress without having to seek no-action assurances from Commission staff. We do not believe that the proposed amendments will have any material impact on competition or capital formation. We request comment on our analysis. What effect would the proposed amendment to rule 17a–9 have on efficiency, competition and capital formation?

*C. Rule 22e–3*

Proposed rule 22e–3 would permit money market funds that break the buck to suspend redemptions and postpone the payment of proceeds pending board-approved liquidation proceedings. We anticipate that the rule would promote efficiency in the financial markets by facilitating orderly disposal of assets during liquidation. To the extent that investors choose money market funds over alternative investments because the proposed rule would provide reassurance as to the protection of their assets in the event the fund breaks the buck and minimize disruption in the financial markets, the rule also may promote capital formation. If, however, the possibility that redemptions can be suspended during a liquidation makes money market funds less appealing to investors, the rule may have a negative effect on capital formation. The proposed rule also could help make investors more confident that they would be able to receive the proceeds from their investment in the event of a liquidation of the fund. We do not believe that the proposed rule would have an adverse effect on competition. We request comment on what effect the proposed rule would have on competition, efficiency, and capital formation.

*D. Rule 30b1–6 and Form N–MFP: Monthly Reporting of Portfolio Holdings*

Proposed new rule 30b1–6 and Form N–MFP would mandate the monthly electronic filing of each money market fund's portfolio holdings information in XML-tagged format. As discussed above, we believe the new reporting requirement would improve the efficiency and effectiveness of the Commission's oversight of money market funds. The availability, and usability, of this data would also promote efficiency for other third-parties that may be interested in collecting and analyzing money market funds' portfolio holdings information. Money market funds currently are often required to provide this information to various third parties in different formats. To the extent that the proposal may encourage a standardized format for disclosure or transmission of portfolio holdings information, the proposal may promote efficiency for money market funds. We do not believe that the proposed rule would have an adverse effect on competition or capital formation. We request comment on what effect the proposed rule would have on competition, efficiency, and capital formation.

## VII. Regulatory Flexibility Act Certification

Section 3(a) of the Regulatory Flexibility Act of 1980[415] (''RFA'') requires the Commission to undertake an initial regulatory flexibility analysis (''IRFA'') of the proposed rule amendments on small entities unless the Commission certifies that the rule, if adopted, would not have a significant economic impact on a substantial number of small entities.[416] Pursuant to 5 U.S.C. section 605(b), the Commission hereby certifies that the proposed amendments to rules 2a–7, 17a–9, and 30b1–5, and proposed rules 30b1–6 and 22e–3 under the Investment Company Act, would not, if adopted, have a significant economic impact on a substantial number of small entities.

The proposal would amend rule 2a–7 under the Investment Company Act to:

(i) Limit money market fund investments to first tier securities (*i.e.,* securities that received the highest short-term ratings categories from the requisite NRSROs or unrated securities that the board of directors (or its delegate) determines are of comparable quality);

(ii) Limit money market funds to acquiring long-term securities that have received long-term ratings in the highest two ratings categories from the requisite NRSROs;

(iii) Reduce the maximum weighted average maturity of money market funds' portfolio securities from 90 to 60 days;

(iv) Require money market funds to maintain a maximum weighted average life to maturity of portfolio securities of no more than 120 days;

(v) Eliminate a provision of the rule that permits a fund that relies exclusively on the penny-rounding method of pricing to acquire Government securities with remaining maturities of up to 762 days, rather than the 397-day limit otherwise provided by the rule;

(vi) Prohibit money market funds from acquiring securities unless, at the time acquired, they are liquid, *i.e.,* can be sold or disposed of in the ordinary course of business within seven days at approximately the value ascribed to it by the money market fund;

(vii) Require that immediately after the acquisition of a security, a taxable ''retail fund'' hold no less than 5 percent of its total assets in cash, U.S. Treasury securities, or other securities (including repurchase agreements) that mature, or are subject to a demand feature exercisable in one business day, and (ii) an ''institutional fund'' hold no less than 10 percent of those instruments;

(viii) Require that immediately after the acquisition of a security (i) a ''retail fund'' holds no less than 15 percent of its total assets in cash, U.S. Treasury securities, or other securities (including repurchase agreements) that are convertible to cash within five business days, and (ii) an ''institutional fund'' holds no less than 30 percent of those instruments;

(ix) Require that a money market fund at all times hold cash, U.S. Treasury securities, or securities readily convertible to cash on a daily or weekly basis sufficient to meet reasonably foreseeable redemptions in light of its obligations under section 22(e) of the Act and any commitments the fund has made to shareholders;

(x) Require the board of directors of each money market fund to adopt procedures providing for periodic stress testing of the money market fund's ability to maintain a stable net asset value per share based on certain hypothetical events, a report of the testing results to the board, and an assessment by the fund's adviser of the fund's ability to withstand the events that are reasonably likely to occur within the following year;

(xi) Limit money market funds to investing in repurchase agreements collateralized by cash items or Government securities in order to obtain special treatment under the diversification provisions of rule 2a–7;

(xii) Require that the money market fund's board of directors or its delegate evaluate the creditworthiness of the

[413] *See* proposed rule 17a–9(a).

[414] *See* proposed rule 17a–9(b).

[415] 5 U.S.C. 603(a).

[416] 5 U.S.C. 605(b).

counterparty, regardless of whether the repurchase agreement is collateralized fully;

(xiii) Require money market funds to post monthly portfolio information on their Web sites; and

(xiv) Require that a money market fund's board determine, on an annual basis, that the fund (or its transfer agent) has the capacity to redeem and sell securities at prices that do not correspond to the fund's stable net asset value.

We also are proposing to amend rule 17a–9 to permit a money market fund to sell a portfolio security that has defaulted (other than an immaterial default unrelated to the financial condition of the issuer) to an affiliated person for the greater of the security's amortized cost value or market value (plus accrued and unpaid interest), even though the security continues to be an eligible security. In addition, we are proposing to permit an affiliated person, for any reason, to purchase any other portfolio security (*e.g.,* an eligible security that has not defaulted) from an affiliated money market fund for cash at the greater of the security's amortized cost value or market value, provided that such person promptly remits to the fund any profit it realizes from the later sale of the security. Under the proposal, a money market fund whose portfolio securities are purchased in reliance on rule 17a–9 would be required to provide notice of the transaction to the Commission by e-mail.

We are also proposing to amend rule 30b1–5 to exempt money market funds from the requirement to file their schedules of investments pursuant to Item 1 of Form N–Q, a quarterly schedule of portfolio holdings of management investment companies. The proposed amendment is intended to avoid unnecessarily duplicative disclosure obligations.

Finally, we are proposing two new rules. Proposed rule 22e–3 would exempt money market funds from section 22(e) to permit them to suspend redemptions in order to facilitate an orderly liquidation of fund assets. Rule 30b1–6 would mandate the monthly electronic filing in XML-tagged format of valuation and other information about the risk characteristics of the money market fund and each security in its portfolio.

Based on information in filings submitted to the Commission, we believe that there are no money market funds that are small entities.[417] For this reason, the Commission believes the proposed amendments to rules 2a–7, 17a–9, and 30b1–5, and proposed rules 22e–3 and 30b1–6 under the Investment Company Act would not, if adopted, have a significant economic impact on a substantial number of small entities.

We encourage written comments regarding this certification. The Commission solicits comment as to whether the proposed amendments to rules 2a–7, 17a–9, and 30b1–5, and proposed rules 22e–3 and 30b1–6 could have an effect on small entities that has not been considered. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

## VIII. Statutory Authority

The Commission is proposing amendments to rule 2a–7 under the exemptive and rulemaking authority set forth in sections 6(c), 8(b), 22(c), and 38(a) of the Investment Company Act of 1940 [15 U.S.C. 80a–6(c), 80a–8(b), 80a–22(c), 80a–37(a)]. The Commission is proposing amendments to rule 17a–9 pursuant to the authority set forth in sections 6(c) and 38(a) of the Investment Company Act [15 U.S.C. 80a–6(c), 80a–37(a)]. The Commission is proposing rule 22e–3 pursuant to the authority set forth in sections 6(c), 22(e) and 38(a) of the Investment Company Act [15 U.S.C. 80a–6(c), 80a–22(e), and 80a–37(a)]. The Commission is proposing amendments to rule 30b1–5 and new rule 30b1–6 and Form N–MFP pursuant to authority set forth in Sections 8(b), 30(b), 31(a), and 38(a) of the Investment Company Act [15 U.S.C. 80a–8(b), 80a–29(b), 80a–30(a), and 80a–37(a)].

## List of Subjects in 17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

## Text of Proposed Rules and Form

For reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

## PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for part 270 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 80a–1 *et seq.,* 80a–34(d), 80a–37, and 80a–39, unless otherwise noted.

* * * * *

2. Section 270.2a–7 is revised to read as follows:

### § 270.2a–7 Money market funds.

(a) *Definitions.* (1) *Acquisition (or Acquire)* means any purchase or subsequent rollover (but does not include the failure to exercise a Demand Feature).

(2) *Amortized Cost Method* of valuation means the method of calculating an investment company's net asset value whereby portfolio securities are valued at the fund's Acquisition cost as adjusted for amortization of premium or accretion of discount rather than at their value based on current market factors.

(3) *Asset Backed Security* means a fixed income security (other than a Government security) issued by a Special Purpose Entity (as defined in this paragraph), substantially all of the assets which consist of Qualifying Assets (as defined in this paragraph). *Special Purpose Entity* means a trust, corporation, partnership or other entity organized for the sole purpose of issuing securities that entitle their holders to receive payments that depend primarily on the cash flow from Qualifying Assets, but does not include a registered investment company. *Qualifying Assets* means financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders.

(4) *Business Day* means any day, other than Saturday, Sunday, or any customary business holiday.

(5) *Collateralized Fully* means ''Collateralized Fully'' as defined in § 270.5b–3(c)(1) except that § 270.5b–3(c)(1)(iv)(C) and (D) shall not apply.

(6) *Conditional Demand Feature* means a Demand Feature that is not an Unconditional Demand Feature. A Conditional Demand Feature is not a Guarantee.

(7) *Conduit Security* means a security issued by a Municipal Issuer (as defined in this paragraph) involving an arrangement or agreement entered into, directly or indirectly, with a person other than a Municipal Issuer, which arrangement or agreement provides for or secures repayment of the security. *Municipal Issuer* means a state or territory of the United States (including the District of Columbia), or any political subdivision or public instrumentality of a state or territory of the United States. A Conduit Security does not include a security that is:

(i) Fully and unconditionally guaranteed by a Municipal Issuer;

[417] Under rule 0–10 under the Investment Company Act, an investment company is considered a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.

(ii) Payable from the general revenues of the Municipal Issuer or other Municipal Issuers (other than those revenues derived from an agreement or arrangement with a person who is not a Municipal Issuer that provides for or secures repayment of the security issued by the Municipal Issuer);

(iii) Related to a project owned and operated by a Municipal Issuer; or

(iv) Related to a facility leased to and under the control of an industrial or commercial enterprise that is part of a public project which, as a whole, is owned and under the control of a Municipal Issuer.

(8) *Daily Liquid Assets* means:

(i) Cash;

(ii) Direct obligations of the U.S. Government; or

(iii) Securities that will mature or are subject to a Demand Feature that is exercisable and payable within one Business Day.

(9) *Demand Feature* means:

(i) A feature permitting the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the time of exercise. A Demand Feature must be exercisable either:

(A) At any time on no more than 30 calendar days' notice;

(B) At specified intervals not exceeding 397 calendar days and upon no more than 30 calendar days' notice; or

(ii) A feature permitting the holder of an Asset Backed Security unconditionally to receive principal and interest within 397 calendar days of making demand.

(10) *Demand Feature Issued By A Non-Controlled Person* means a Demand Feature issued by:

(i) A person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the Demand Feature (*control* means ''control'' as defined in section 2(a)(9) of the Act (15 U.S.C. 80a–2(a)(9)); or

(ii) A sponsor of a Special Purpose Entity with respect to an Asset Backed Security.

(11) *Eligible Security* means:

(i) A security issued by a registered investment company that is a money market fund;

(ii) A Government Security;

(iii) A Rated Security with a remaining maturity of 397 calendar days or less that has received a rating from the Requisite NRSROs in the highest short-term rating category (within which there may be sub-categories or gradations indicating relative standing); or

(iv) An Unrated Security that is of comparable quality to a security meeting the requirements for a Rated Security in paragraph (a)(11)(iii) of this section, as determined by the money market fund's board of directors; provided, however, that:

(A) A security that at the time of issuance had a remaining maturity of more than 397 calendar days but that has a remaining maturity of 397 calendar days or less and that is an Unrated Security is not an Eligible Security if the security has received a long-term rating from any NRSRO that is not within the NRSRO's two highest long-term ratings categories (within which there may be sub-categories or gradations indicating relative standing), unless the security has received a long-term rating from the Requisite NRSROs in one of the two highest rating categories;

(B) An Asset Backed Security (other than an Asset Backed Security substantially all of whose Qualifying Assets consist of obligations of one or more Municipal Issuers, as that term is defined in paragraph (a)(7) of this section) shall not be an Eligible Security unless it has received a rating from an NRSRO.

(v) In addition, in the case of a security that is subject to a Demand Feature or Guarantee:

(A) The Guarantee has received a rating from an NRSRO or the Guarantee is issued by a guarantor that has received a rating from an NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security to the Guarantee, unless:

(*1*) The Guarantee is issued by a person that, directly or indirectly, controls, is controlled by or is under common control with the issuer of the security subject to the Guarantee (other than a sponsor of a Special Purpose Entity with respect to an Asset Backed Security);

(*2*) The security subject to the Guarantee is a repurchase agreement that is Collateralized Fully; or

(*3*) The Guarantee is itself a Government Security; and

(B) The issuer of the Demand Feature or Guarantee, or another institution, has undertaken promptly to notify the holder of the security in the event the Demand Feature or Guarantee is substituted with another Demand Feature or Guarantee (if such substitution is permissible under the terms of the Demand Feature or Guarantee).

(12) *Event of Insolvency* means ''Event of Insolvency'' as defined in § 270.5b–3(c)(2).

(13) *Floating Rate Security* means a security the terms of which provide for the adjustment of its interest rate whenever a specified interest rate changes and that, at any time until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

(14) *Government Security* means any ''Government security'' as defined in section 2(a)(16) of the Act (15 U.S.C. 80a–2(a)(16)).

(15) *Guarantee* means an unconditional obligation of a person other than the issuer of the security to undertake to pay, upon presentment by the holder of the Guarantee (if required), the principal amount of the underlying security plus accrued interest when due or upon default, or, in the case of an Unconditional Demand Feature, an obligation that entitles the holder to receive upon exercise the approximate amortized cost of the underlying security or securities, plus accrued interest, if any. A Guarantee includes a letter of credit, financial guaranty (bond) insurance, and an Unconditional Demand Feature (other than an Unconditional Demand Feature provided by the issuer of the security).

(16) *Guarantee Issued By A Non-Controlled Person* means a Guarantee issued by:

(i) A person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the Guarantee (control means ''control'' as defined in section 2(a)(9) of the Act (15 U.S.C. 80a–2(a)(9)); or

(ii) A sponsor of a Special Purpose Entity with respect to an Asset Backed Security.

(17) *Institutional Fund* means a money market fund whose board of directors determines, no less frequently than once each calendar year, is intended to be offered primarily to institutional investors or has the characteristics of such a fund, based on the:

(i) Nature of the record owners of the fund's shares;

(ii) Minimum initial investment requirements; and

(iii) Historical cash flows that have resulted or expected cash flows that would result from purchases and redemptions.

(18) *Liquid Security* means a security that can be sold or disposed of in the ordinary course of business within seven calendar days at approximately its amortized cost.

(19) *NRSRO* means any nationally recognized statistical rating organization, as that term is defined in section 3(a)(62) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(62)), that is not an ''affiliated person,'' as defined in section 2(a)(3)(C) of the Act (15 U.S.C. 80a–2(a)(3)(C)), of the issuer of, or any insurer or provider of credit support for, the security.

(20) *Penny-Rounding Method* of pricing means the method of computing an investment company's price per share for purposes of distribution, redemption and repurchase whereby the current net asset value per share is rounded to the nearest one percent.

(21) *Rated Security* means a security that meets the requirements of paragraphs (a)(21)(i) or (ii) of this section, in each case subject to paragraph (a)(21)(iii) of this section:

(i) The security has received a short-term rating from an NRSRO, or has been issued by an issuer that has received a short-term rating from an NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security with the security; or

(ii) The security is subject to a Guarantee that has received a short-term rating from an NRSRO, or a Guarantee issued by a guarantor that has received a short-term rating from an NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security with the Guarantee; but

(iii) A security is not a Rated Security if it is subject to an external credit support agreement (including an arrangement by which the security has become a Refunded Security) that was not in effect when the security was assigned its rating, unless the security has received a short-term rating reflecting the existence of the credit support agreement as provided in paragraph (a)(21)(i) of this section, or the credit support agreement with respect to the security has received a short-term rating as provided in paragraph (a)(21)(ii) of this section.

(22) *Refunded Security* means ''Refunded Security'' as defined in § 270.5b–3(c)(4).

(23) *Requisite NRSROs* means:

(i) Any two NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer; or

(ii) If only one NRSRO has issued a rating with respect to such security or class of debt obligations of an issuer at the time the fund acquires the security, that NRSRO.

(24) *Retail Fund* means any money market fund that the board of directors has not determined within the calendar year is an Institutional Fund under paragraph (c)(5)(v) of this section.

(25) *Single State Fund* means a Tax Exempt Fund that holds itself out as seeking to maximize the amount of its distributed income that is exempt from the income taxes or other taxes on investments of a particular state and, where applicable, subdivisions thereof.

(26) *Tax Exempt Fund* means any money market fund that holds itself out as distributing income exempt from regular federal income tax.

(27) *Total Assets* means, with respect to a money market fund using the Amortized Cost Method, the total amortized cost of its assets and, with respect to any other money market fund, the total market-based value of its assets.

(28) *Unconditional Demand Feature* means a Demand Feature that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security or securities.

(29) *United States Dollar-Denominated* means, with reference to a security, that all principal and interest payments on such security are payable to security holders in United States dollars under all circumstances and that the interest rate of, the principal amount to be repaid, and the timing of payments related to such security do not vary or float with the value of a foreign currency, the rate of interest payable on foreign currency borrowings, or with any other interest rate or index expressed in a currency other than United States dollars.

(30) *Unrated Security* means a security that is not a Rated Security.

(31) *Variable Rate Security* means a security the terms of which provide for the adjustment of its interest rate on set dates (such as the last day of a month or calendar quarter) and that, upon each adjustment until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

(32) *Weekly Liquid Assets* means:

(i) Cash;

(ii) Direct obligations of the U.S. Government; or

(iii) Securities that will mature or are subject to a Demand Feature that is exercisable and payable within five Business Days.

(b) *Holding Out and Use of Names and Titles.* (1) It shall be an untrue statement of material fact within the meaning of section 34(b) of the Act (15 U.S.C. 80a–33(b)) for a registered investment company, in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Act, including any advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors that is required to be filed with the Commission by section 24(b) of the Act (15 U.S.C. 80a–24(b)), to hold itself out to investors as a money market fund or the equivalent of a money market fund, unless such registered investment company meets the conditions of paragraphs (c)(2), (c)(3), (c)(4) and (c)(5) of this section.

(2) It shall constitute the use of a materially deceptive or misleading name or title within the meaning of section 35(d) of the Act (15 U.S.C. 80a–34(d)) for a registered investment company to adopt the term ''money market'' as part of its name or title or the name or title of any redeemable securities of which it is the issuer, or to adopt a name that suggests that it is a money market fund or the equivalent of a money market fund, unless such registered investment company meets the conditions of paragraphs (c)(2), (c)(3), (c)(4), and (c)(5) of this section.

(3) For purposes of this paragraph, a name that suggests that a registered investment company is a money market fund or the equivalent thereof shall include one that uses such terms as ''cash,'' ''liquid,'' ''money,'' ''ready assets'' or similar terms.

(c) *Share Price Calculations.* The current price per share, for purposes of distribution, redemption and repurchase, of any redeemable security issued by any registered investment company (''money market fund'' or ''fund''), notwithstanding the requirements of section 2(a)(41) of the Act (15 U.S.C. 80a–2(a)(41)) and of §§ 270.2a–4 and 270.22c–1 thereunder, may be computed by use of the Amortized Cost Method or the Penny-Rounding Method; provided, however, that:

(1) *Board Findings.* The board of directors of the money market fund shall determine, in good faith, that it is in the best interests of the fund and its shareholders to maintain a stable net asset value per share or stable price per share, by virtue of either the Amortized Cost Method or the Penny-Rounding Method, and that the money market fund will continue to use such method only so long as the board of directors believes that it fairly reflects the market-based net asset value per share. The board shall annually determine in good faith that the fund (or its transfer agent) has the capacity to redeem and sell securities issued by the fund at a price

based on the current net asset value per share pursuant to § 270.22c–1. Such capacity shall include the ability to redeem and sell securities at prices that do not correspond to a stable net asset value or price per share.

(2) *Portfolio Maturity.* The money market fund shall maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value per share or price per share; provided, however, that the money market fund will not:

(i) Acquire any instrument with a remaining maturity of greater than 397 calendar days;

(ii) Maintain a dollar-weighted average portfolio maturity that exceeds 60 calendar days; or

(iii) Maintain a dollar-weighted average portfolio maturity that exceeds 120 calendar days, determined without reference to the exceptions in paragraph (d) of this section regarding interest rate readjustments.

(3) *Portfolio Quality.* (i) *General.* The money market fund shall limit its portfolio investments to those United States Dollar-Denominated securities that the fund's board of directors determines present minimal credit risks (which determination must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by an NRSRO) and that are at the time of Acquisition Eligible Securities.

(ii) *Securities Subject to Guarantees.* A security that is subject to a Guarantee may be determined to be an Eligible Security based solely on whether the Guarantee is an Eligible Security.

(iii) *Securities Subject to Conditional Demand Features.* A security that is subject to a Conditional Demand Feature (''Underlying Security'') may be determined to be an Eligible Security only if:

(A) The Conditional Demand Feature is an Eligible Security;

(B) At the time of the Acquisition of the Underlying Security, the money market fund's board of directors has determined that there is minimal risk that the circumstances that would result in the Conditional Demand Feature not being exercisable will occur; and

(*1*) The conditions limiting exercise either can be monitored readily by the fund, or relate to the taxability, under federal, state or local law, of the interest payments on the security; or

(*2*) The terms of the Conditional Demand Feature require that the fund will receive notice of the occurrence of the condition and the opportunity to exercise the Demand Feature in accordance with its terms; and

(C) The Underlying Security or any Guarantee of such security (or the debt securities of the issuer of the Underlying Security or Guarantee that are comparable in priority and security with the Underlying Security or Guarantee) has received either a short-term rating or a long-term rating, as the case may be, from the Requisite NRSROs within the NRSROs' highest short-term or long-term rating categories (within which there may be sub-categories or gradations indicating relative standing) or, if unrated, is determined to be of comparable quality by the money market fund's board of directors to a security that has received a rating from the Requisite NRSROs within the NRSROs' highest short-term or long-term rating categories, as the case may be.

(4) *Portfolio Diversification.* (i) *Issuer Diversification.* The money market fund shall be diversified with respect to issuers of securities Acquired by the fund as provided in paragraphs (c)(4)(i) and (c)(4)(ii) of this section, other than with respect to Government Securities and securities subject to a Guarantee Issued By A Non-Controlled Person.

(A) *Taxable and National Funds.* Immediately after the Acquisition of any security, a money market fund other than a Single State Fund shall not have invested more than five percent of its Total Assets in securities issued by the issuer of the security; provided, however, that such a fund may invest up to twenty-five percent of its Total Assets in the securities of a single issuer for a period of up to three Business Days after the Acquisition thereof; Provided, further, that the fund may not invest in the securities of more than one issuer in accordance with the foregoing proviso in this paragraph at any time.

(B) *Single State Funds.* With respect to seventy-five percent of its Total Assets, immediately after the Acquisition of any security, a Single State Fund shall not have invested more than five percent of its Total Assets in securities issued by the issuer of the security.

(ii) *Issuer Diversification Calculations.* For purposes of making calculations under paragraph (c)(4)(i) of this section:

(A) *Repurchase Agreements.* The Acquisition of a repurchase agreement may be deemed to be an Acquisition of the underlying securities, provided the obligation of the seller to repurchase the securities from the money market fund is Collateralized Fully and the fund's board of directors has evaluated the seller's creditworthiness.

(B) *Refunded Securities.* The Acquisition of a Refunded Security shall be deemed to be an Acquisition of the escrowed Government Securities.

(C) *Conduit Securities.* A Conduit Security shall be deemed to be issued by the person (other than the Municipal Issuer) ultimately responsible for payments of interest and principal on the security.

(D) *Asset Backed Securities.* (*1*) *General.* An Asset Backed Security Acquired by a fund (''Primary ABS'') shall be deemed to be issued by the Special Purpose Entity that issued the Asset Backed Security; provided, however:

(*i*) Holdings of Primary ABS. Any person whose obligations constitute ten percent or more of the principal amount of the Qualifying Assets of the Primary ABS (''Ten Percent Obligor'') shall be deemed to be an issuer of the portion of the Primary ABS such obligations represent; and

(*ii*) Holdings of Secondary ABS. If a Ten Percent Obligor of a Primary ABS is itself a Special Purpose Entity issuing Asset Backed Securities (''Secondary ABS''), any Ten Percent Obligor of such Secondary ABS also shall be deemed to be an issuer of the portion of the Primary ABS that such Ten Percent Obligor represents.

(*2*) *Restricted Special Purpose Entities.* A Ten Percent Obligor with respect to a Primary or Secondary ABS shall not be deemed to have issued any portion of the assets of a Primary ABS as provided in paragraph (c)(4)(ii)(D)(1) of this section if that Ten Percent Obligor is itself a Special Purpose Entity issuing Asset Backed Securities (''Restricted Special Purpose Entity''), and the securities that it issues (other than securities issued to a company that controls, or is controlled by or under common control with, the Restricted Special Purpose Entity and which is not itself a Special Purpose Entity issuing Asset Backed Securities) are held by only one other Special Purpose Entity.

(*3*) *Demand Features and Guarantees.* In the case of a Ten Percent Obligor deemed to be an issuer, the fund shall satisfy the diversification requirements of paragraph (c)(4)(iii) of this section with respect to any Demand Feature or Guarantee to which the Ten Percent Obligor's obligations are subject.

(E) *Shares of Other Money Market Funds.* A money market fund that Acquires shares issued by another money market fund in an amount that would otherwise be prohibited by paragraph (c)(4)(i) of this section shall nonetheless be deemed in compliance with this section if the board of directors of the Acquiring money market fund reasonably believes that the fund

in which it has invested is in compliance with this section.

(iii) *Diversification Rules for Demand Features and Guarantees.* The money market fund shall be diversified with respect to Demand Features and Guarantees Acquired by the fund as provided in paragraphs (c)(4)(iii) and (c)(4)(iv) of this section, other than with respect to a Demand Feature issued by the same institution that issued the underlying security, or with respect to a Guarantee or Demand Feature that is itself a Government Security.

(A) *General.* Immediately after the Acquisition of any Demand Feature or Guarantee or security subject to a Demand Feature or Guarantee, a money market fund, with respect to seventy-five percent of its Total Assets, shall not have invested more than ten percent of its Total Assets in securities issued by or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee, subject to paragraph (c)(4)(iii)(B) of this section.

(B) *Demand Features or Guarantees Issued by Non-Controlled Persons.* Immediately after the Acquisition of any security subject to a Demand Feature or Guarantee, a money market fund shall not have invested more than ten percent of its Total Assets in securities issued by, or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee, unless, with respect to any security subject to Demand Features or Guarantees from that institution (other than securities issued by such institution), the Demand Feature or Guarantee is a Demand Feature or Guarantee Issued By A Non-Controlled Person.

(iv) *Demand Feature and Guarantee Diversification Calculations.* (A) *Fractional Demand Features or Guarantees.* In the case of a security subject to a Demand Feature or Guarantee from an institution by which the institution guarantees a specified portion of the value of the security, the institution shall be deemed to guarantee the specified portion thereof.

(B) *Layered Demand Features or Guarantees.* In the case of a security subject to Demand Features or Guarantees from multiple institutions that have not limited the extent of their obligations as described in paragraph (c)(4)(iv)(A) of this section, each institution shall be deemed to have provided the Demand Feature or Guarantee with respect to the entire principal amount of the security.

(v) *Diversification Safe Harbor.* A money market fund that satisfies the applicable diversification requirements of paragraphs (c)(4) and (c)(6) of this section shall be deemed to have satisfied the diversification requirements of section 5(b)(1) of the Act (15 U.S.C. 80a–5(b)(1)) and the rules adopted thereunder.

(5) *Portfolio Liquidity.* (i) *Liquid Securities.* The money market fund shall limit its portfolio investments to cash and securities that at the time of Acquisition are Liquid Securities.

(ii) *General Liquidity Requirement.* The money market fund shall hold Daily Liquid Assets and Weekly Liquid Assets sufficient to meet reasonably foreseeable shareholder redemptions in light of the fund's obligations under section 22(e) of the Act (15 U.S.C. 80a–22(e)) and any commitments the fund has made to shareholders.

(iii) *Minimum Daily Liquidity Requirement.* A money market fund shall not Acquire any security other than a Daily Liquid Asset if, immediately after the Acquisition, a Retail Fund would have invested less than five percent of its Total Assets, and an Institutional Fund would have invested less than ten percent of its Total Assets, in Daily Liquid Assets. This provision shall not apply to Tax Exempt Funds.

(iv) *Minimum Weekly Liquidity Requirement.* A money market fund shall not Acquire any security if, immediately after the Acquisition, a Retail Fund would have invested less than fifteen percent of its Total Assets, and an Institutional Fund would have invested less than thirty percent of its Total Assets, in Weekly Liquid Assets.

(v) *Annual Board Determination.* The board of directors of each money market fund shall determine no less than once each calendar year whether the fund is an Institutional Fund for purposes of meeting the minimum liquidity requirements set forth in paragraphs (c)(5)(iii) and (iv) of this section.

(6) *Demand Features and Guarantees Not Relied Upon.* If the fund's board of directors has determined that the fund is not relying on a Demand Feature or Guarantee to determine the quality (pursuant to paragraph (c)(3) of this section), or maturity (pursuant to paragraph (d) of this section), or liquidity of a portfolio security, and maintains a record of this determination (pursuant to paragraphs (c)(10)(ii) and (c)(11)(vi) of this section), then the fund may disregard such Demand Feature or Guarantee for all purposes of this section.

(7) *Downgrades, Defaults and Other Events.* (i) *Downgrades.* (A) *General.* In the event that the money market fund's investment adviser (or any person to whom the fund's board of directors has delegated portfolio management responsibilities) becomes aware that any Unrated Security held by the money market fund has, since the security was Acquired by the fund, been given a rating by any NRSRO below the NRSRO's highest short-term rating category, the board of directors of the money market fund shall reassess promptly whether such security continues to present minimal credit risks and shall cause the fund to take such action as the board of directors determines is in the best interests of the money market fund and its shareholders.

(B) The reassessment required by paragraph (c)(7)(i)(A) of this section shall not be required if the fund disposes of the security (or it matures) within five Business Days.

(ii) *Defaults and Other Events.* Upon the occurrence of any of the events specified in paragraphs (c)(7)(ii)(A) through (D) of this section with respect to a portfolio security, the money market fund shall dispose of such security as soon as practicable consistent with achieving an orderly disposition of the security, by sale, exercise of any Demand Feature or otherwise, absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money market fund (which determination may take into account, among other factors, market conditions that could affect the orderly disposition of the portfolio security):

(A) The default with respect to a portfolio security (other than an immaterial default unrelated to the financial condition of the issuer);

(B) A portfolio security ceases to be an Eligible Security;

(C) A portfolio security has been determined to no longer present minimal credit risks; or

(D) An Event of Insolvency occurs with respect to the issuer of a portfolio security or the provider of any Demand Feature or Guarantee.

(iii) *Notice to the Commission.* The money market fund shall promptly notify the Commission by electronic mail directed to the Director of Investment Management or the Director's designee, of any:

(A) Default with respect to one or more portfolio securities (other than an immaterial default unrelated to the financial condition of the issuer) or an Event of Insolvency with respect to the issuer of the security or any Demand Feature or Guarantee to which it is subject, where immediately before default the securities (or the securities subject to the Demand Feature or Guarantee) accounted for ½ of 1 percent

or more of a money market fund's Total Assets, the money market fund shall promptly notify the Commission of such fact and the actions the money market fund intends to take in response to such situation; or

(B) Purchase of a security from the fund by an affiliated person in reliance on § 270.17a–9 of this section, and the reasons for such purchase.

(iv) *Defaults for Purposes of Paragraphs (c)(7)(ii) and (iii).* For purposes of paragraphs (c)(7)(ii) and (iii) of this section, an instrument subject to a Demand Feature or Guarantee shall not be deemed to be in default (and an Event of Insolvency with respect to the security shall not be deemed to have occurred) if:

(A) In the case of an instrument subject to a Demand Feature, the Demand Feature has been exercised and the fund has recovered either the principal amount or the amortized cost of the instrument, plus accrued interest; or

(B) The provider of the Guarantee is continuing, without protest, to make payments as due on the instrument.

(8) *Required Procedures: Amortized Cost Method.* In the case of a money market fund using the Amortized Cost Method:

(i) *General.* In supervising the money market fund's operations and delegating special responsibilities involving portfolio management to the money market fund's investment adviser, the money market fund's board of directors, as a particular responsibility within the overall duty of care owed to its shareholders, shall establish written procedures reasonably designed, taking into account current market conditions and the money market fund's investment objectives, to stabilize the money market fund's net asset value per share, as computed for the purpose of distribution, redemption and repurchase, at a single value.

(ii) *Specific Procedures.* Included within the procedures adopted by the board of directors shall be the following:

(A) *Shadow Pricing.* Written procedures shall provide:

(*1*) That the extent of deviation, if any, of the current net asset value per share calculated using available market quotations (or an appropriate substitute that reflects current market conditions) from the money market fund's amortized cost price per share, shall be calculated at such intervals as the board of directors determines appropriate and reasonable in light of current market conditions;

(*2*) For the periodic review by the board of directors of the amount of the deviation as well as the methods used to calculate the deviation; and

(*3*) For the maintenance of records of the determination of deviation and the board's review thereof.

(B) *Prompt Consideration of Deviation.* In the event such deviation from the money market fund's amortized cost price per share exceeds ½ of 1 percent, the board of directors shall promptly consider what action, if any, should be initiated by the board of directors.

(C) *Material Dilution or Unfair Results.* Where the board of directors believes the extent of any deviation from the money market fund's amortized cost price per share may result in material dilution or other unfair results to investors or existing shareholders, it shall cause the fund to take such action as it deems appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results.

(D) *Stress Testing.* Written procedures shall provide for:

(*1*) The periodic testing, at such intervals as the board of directors determines appropriate and reasonable in light of current market conditions, of the money market fund's ability to maintain a stable net asset value per share based upon specified hypothetical events, that include, but are not limited to, a change in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on portfolio securities, and the widening or narrowing of spreads between yields on an appropriate benchmark the fund has selected for overnight interest rates and commercial paper and other types of securities held by the fund;

(*2*) A report on the results of such testing to be provided to the board of directors at its next regularly scheduled meeting, which report shall include the date(s) on which the testing was performed and the magnitude of each hypothetical event that would cause the deviation of the money market fund's net asset value calculated using available market quotations (or appropriate substitutes which reflect current market conditions) from its net asset value per share calculated using amortized cost to exceed ½ of 1 percent; and

(*3*) 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.

(9) *Required Procedures: Penny-Rounding Method.* In the case of a money market fund using the Penny-Rounding Method, in supervising the money market fund's operations and delegating special responsibilities involving portfolio management to the money market fund's investment adviser, the money market fund's board of directors undertakes, as a particular responsibility within the overall duty of care owed to its shareholders, to assure to the extent reasonably practicable, taking into account current market conditions affecting the money market fund's investment objectives, that the money market fund's price per share as computed for the purpose of distribution, redemption and repurchase, rounded to the nearest one percent, will not deviate from the single price established by the board of directors.

(10) *Specific Procedures: Amortized Cost and Penny-Rounding Methods.* Included within the procedures adopted by the board of directors for money market funds using either the Amortized Cost or Penny-Rounding Methods shall be the following:

(i) *Securities for Which Maturity Is Determined by Reference to Demand Features.* In the case of a security for which maturity is determined by reference to a Demand Feature, written procedures shall require ongoing review of the security's continued minimal credit risks, and that review must be based on, among other things, financial data for the most recent fiscal year of the issuer of the Demand Feature and, in the case of a security subject to a Conditional Demand Feature, the issuer of the security whose financial condition must be monitored under paragraph (c)(3)(iv) of this section, whether such data is publicly available or provided under the terms of the security's governing documentation.

(ii) *Securities Subject to Demand Features or Guarantees.* In the case of a security subject to one or more Demand Features or Guarantees that the fund's board of directors has determined that the fund is not relying on to determine the quality (pursuant to paragraph (c)(3) of this section), maturity (pursuant to paragraph (d) of this section) or liquidity of the security subject to the Demand Feature or Guarantee, written procedures shall require periodic evaluation of such determination.

(iii) *Adjustable Rate Securities Without Demand Features.* In the case of a Variable Rate or Floating Rate Security that is not subject to a Demand Feature and for which maturity is determined pursuant to paragraphs (d)(1), (d)(2) or (d)(4) of this section, written procedures shall require periodic review of whether the interest rate formula, upon readjustment of its interest rate, can reasonably be expected to cause the

security to have a market value that approximates its amortized cost value.

(iv) *Asset Backed Securities.* In the case of an Asset Backed Security, written procedures shall require the fund to periodically determine the number of Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section) deemed to be the issuers of all or a portion of the Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section; Provided, however, written procedures need not require periodic determinations with respect to any Asset Backed Security that a fund's board of directors has determined, at the time of Acquisition, will not have, or is unlikely to have, Ten Percent Obligors that are deemed to be issuers of all or a portion of that Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section, and maintains a record of this determination.

(11) *Record Keeping and Reporting.* (i) *Written Procedures.* For a period of not less than six years following the replacement of such procedures with new procedures (the first two years in an easily accessible place), a written copy of the procedures (and any modifications thereto) described in paragraphs (c)(7) through (c)(10) and (e) of this section shall be maintained and preserved.

(ii) *Board Considerations and Actions.* For a period of not less than six years (the first two years in an easily accessible place) a written record shall be maintained and preserved of the board of directors' considerations and actions taken in connection with the discharge of its responsibilities, as set forth in this section, to be included in the minutes of the board of directors' meetings.

(iii) *Credit Risk Analysis.* For a period of not less than three years from the date that the credit risks of a portfolio security were most recently reviewed, a written record of the determination that a portfolio security presents minimal credit risks and the NRSRO ratings (if any) used to determine the status of the security as an Eligible Security shall be maintained and preserved in an easily accessible place.

(iv) *Determinations With Respect to Adjustable Rate Securities.* For a period of not less than three years from the date when the determination was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the determination required by paragraph (c)(10)(iii) of this section (that a Variable Rate or Floating Rate Security that is not subject to a Demand Feature and for which maturity is determined pursuant to paragraphs (d)(1), (d)(2) or (d)(4) of this section can reasonably be expected, upon readjustment of its interest rate at all times during the life of the instrument, to have a market value that approximates its amortized cost).

(v) *Determinations with Respect to Asset Backed Securities.* For a period of not less than three years from the date when the determination was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the determinations required by paragraph (c)(10)(iv) of this section (the number of Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section) deemed to be the issuers of all or a portion of the Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section). The written record shall include:

(A) The identities of the Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section), the percentage of the Qualifying Assets constituted by the securities of each Ten Percent Obligor and the percentage of the fund's Total Assets that are invested in securities of each Ten Percent Obligor; and

(B) Any determination that an Asset Backed Security will not have, or is unlikely to have, Ten Percent Obligors deemed to be issuers of all or a portion of that Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section.

(vi) *Evaluations With Respect to Securities Subject to Demand Features or Guarantees.* For a period of not less than three years from the date when the evaluation was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the evaluation required by paragraph (c)(10)(ii) (regarding securities subject to one or more Demand Features or Guarantees) of this section.

(vii) *Reports and Assessments with Respect to Stress Testing.* For a period of not less than six years (the first two years in an easily accessible place), a written copy of the report required under paragraph (c)(8)(ii)(D)(*2*) of this section and a written record of the assessment required under paragraph (c)(8)(ii)(D)(*3*) of this section shall be maintained and preserved.

(viii) *Inspection of Records.* The documents preserved pursuant to this paragraph (c)(11) shall be subject to inspection by the Commission in accordance with section 31(b) of the Act (15 U.S.C. 80a–30(b)) as if such documents were records required to be maintained pursuant to rules adopted under section 31(a) of the Act (15 U.S.C. 80a–30(a)). If any action was taken under paragraphs (c)(7)(ii) (with respect to defaulted securities and events of insolvency) or (c)(8)(ii) (with respect to a deviation from the fund's share price of more than ½ of 1 percent) of this section, the money market fund will file an exhibit to the Form N–SAR (17 CFR 274.101) filed for the period in which the action was taken describing with specificity the nature and circumstances of such action. The money market fund will report in an exhibit to such Form any securities it holds on the final day of the reporting period that are not Eligible Securities.

(12) *Public Disclosure of Valuations.* The money market fund shall post on its Web site, for a period of not less than twelve months, beginning no later than the second business day of the month, the fund's schedule of investments, as prescribed by rules 12–12 through 12–14 of Regulation S–X [17 CFR 210.12.–12 through 210.12–14], as of the last business day of the prior month.

(d) *Maturity of Portfolio Securities.* For purposes of this section, the maturity of a portfolio security shall be deemed to be the period remaining (calculated from the trade date or such other date on which the fund's interest in the security is subject to market action) until the date on which, in accordance with the terms of the security, the principal amount must unconditionally be paid, or in the case of a security called for redemption, the date on which the redemption payment must be made, except as provided in paragraphs (d)(1) through (d)(8) of this section:

(1) *Adjustable Rate Government Securities.* A Government Security that is a Variable Rate Security where the variable rate of interest is readjusted no less frequently than every 397 calendar days shall be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate. A Government Security that is a Floating Rate Security shall be deemed to have a remaining maturity of one day.

(2) *Short-Term Variable Rate Securities.* A Variable Rate Security, the principal amount of which, in accordance with the terms of the security, must unconditionally be paid in 397 calendar days or less shall be deemed to have a maturity equal to the earlier of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand.

(3) *Long-Term Variable Rate Securities.* A Variable Rate Security, the principal amount of which is scheduled to be paid in more than 397 calendar

days, that is subject to a Demand Feature, shall be deemed to have a maturity equal to the longer of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand.

(4) *Short-Term Floating Rate Securities.* A Floating Rate Security, the principal amount of which, in accordance with the terms of the security, must unconditionally be paid in 397 calendar days or less shall be deemed to have a maturity of one day.

(5) *Long-Term Floating Rate Securities.* A Floating Rate Security, the principal amount of which is scheduled to be paid in more than 397 calendar days, that is subject to a Demand Feature, shall be deemed to have a maturity equal to the period remaining until the principal amount can be recovered through demand.

(6) *Repurchase Agreements.* A repurchase agreement shall be deemed to have a maturity equal to the period remaining until the date on which the repurchase of the underlying securities is scheduled to occur, or, where the agreement is subject to demand, the notice period applicable to a demand for the repurchase of the securities.

(7) *Portfolio Lending Agreements.* A portfolio lending agreement shall be treated as having a maturity equal to the period remaining until the date on which the loaned securities are scheduled to be returned, or where the agreement is subject to demand, the notice period applicable to a demand for the return of the loaned securities.

(8) *Money Market Fund Securities.* An investment in a money market fund shall be treated as having a maturity equal to the period of time within which the Acquired money market fund is required to make payment upon redemption, unless the Acquired money market fund has agreed in writing to provide redemption proceeds to the investing money market fund within a shorter time period, in which case the maturity of such investment shall be deemed to be the shorter period.

(e) *Delegation.* The money market fund's board of directors may delegate to the fund's investment adviser or officers the responsibility to make any determination required to be made by the board of directors under this section (other than the determinations required by paragraphs (c)(1) (board findings); (c)(7)(ii) (defaults and other events); (c)(8)(i) (general required procedures: Amortized Cost Method); (c)(8)(ii)(A) (shadow pricing), (B) (prompt consideration of deviation), and (C) (material dilution or unfair results); and (c)(9) (required procedures: Penny-Rounding Method) of this section) provided:

(1) *Written Guidelines.* The Board shall establish and periodically review written guidelines (including guidelines for determining whether securities present minimal credit risks as required in paragraph (c)(3) of this section) and procedures under which the delegate makes such determinations:

(2) *Oversight.* The Board shall take any measures reasonably necessary (through periodic reviews of fund investments and the delegate's procedures in connection with investment decisions and prompt review of the adviser's actions in the event of the default of a security or Event of Insolvency with respect to the issuer of the security or any Guarantee to which it is subject that requires notification of the Commission under paragraph (c)(7)(iii) of this section) to assure that the guidelines and procedures are being followed.

3. Section 270.17a–9 is revised to read as follows:

**§ 270.17a–9 Purchase of certain securities from a money market fund by an affiliate, or an affiliate of an affiliate.**

The purchase of a security from the portfolio of an open-end investment company holding itself out as a money market fund by any affiliated person or promoter of or principal underwriter for the money market fund or any affiliated person of such person shall be exempt from Section 17(a) of the Act (15 U.S.C. 80a–17(a)); provided that:

(a) In the case of a portfolio security that has ceased to be an Eligible Security (as defined in § 270.2a–7 (a)(11), or has defaulted (other than an immaterial default unrelated to the financial condition of the issuer):

(1) The purchase price is paid in cash; and

(2) The purchase price is equal to the greater of the amortized cost of the security or its market price (in each case, including accrued interest).

(b) In the case of any other portfolio security:

(1) The purchase price meets the requirements of paragraphs (a)(1) and (2) of this section; and

(2) In the event that the purchaser thereafter sells the security for a higher price than the purchase price paid to the money market fund, the purchaser shall promptly pay to the fund the amount by which the subsequent sale price exceeds the purchase price paid to the fund.

4. Section 270.22e–3 is added to read as follows:

**§ 270.22e–3 Exemption for liquidation of money market funds.**

(a) A registered open-end management investment company or series thereof (''fund'') that is regulated as a money market fund under § 270.2a–7 is exempt from the requirements of section 22(e) of the Act (15 U.S.C. 80a–22(e)) if:

(1) The fund's current price per share calculated pursuant to § 270.2a–7(c) is less than the fund's stable net asset value or price per share;

(2) The fund's board of directors, including a majority of directors who are not interested persons of the fund, has approved the liquidation of the fund; and

(3) The fund, prior to suspending redemptions, notifies the Commission of its decision to liquidate and suspend redemptions, by electronic mail directed to the attention of the Director of the Division of Investment Management or his designee.

(b) Any fund that owns, pursuant to section 12(d)(1)(E) of the Act (15 U.S.C. 80a–12(d)(1)(E)), shares of a money market fund that has suspended redemptions of shares pursuant to paragraph (a) of this section also is exempt from the requirements of section 22(e) of the Act. A fund relying on the exemption provided in this paragraph must promptly notify the Commission that it has suspended redemptions in reliance on this section. Notification under this paragraph shall be made by electronic mail directed to the attention of the Director of the Division of Investment Management or his designee.

(c) For the protection of fund shareholders, the Commission may issue an order to rescind or modify the exemption provided by this section as to that fund, after appropriate notice and opportunity for hearing in accordance with section 40 of the Act (15 U.S.C. 80a–39).

5. Section 270.30b1–5 is revised to read as follows:

**§ 270.30b1–5 Quarterly report.**

Every registered management investment company, other than a small business investment company registered on Form N–5 (§§ 239.24 and 274.5 of this chapter), shall file a quarterly report on Form N–Q (§§ 249.332 and 274.130 of this chapter) not more than 60 days after the close of the first and third quarters of each fiscal year. A registered management investment company that has filed a registration statement with the Commission registering its securities for the first time under the Securities Act of 1933 is relieved of this reporting obligation with respect to any reporting

period or portion thereof prior to the date on which that registration statement becomes effective or is withdrawn. A registered management investment company regulated as a money market fund under § 270.2a–7 is relieved of the reporting obligation required pursuant to Item 1 of Form N–Q.

6. Section 270.30b1–6 is added to read as follows:

**§ 270.30b1–6 Monthly report for money market funds.**

Every registered open-end management investment company, or series thereof, that is regulated as a money market fund under § 270.2a–7 must file with the Commission a monthly report of portfolio holdings on Form N–MFP no later than the second business day of each month.

## PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

7. The authority citation for Part 274 continues to read in part as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, and 80a–29, unless otherwise noted.

8. Section 274.201 and Form N–MFP are added to read as follows:

**§ 274.201 Form N–MFP, Portfolio Holdings of Money Market Funds.**

This form shall be used by registered management investment companies that are regulated as money market funds under § 270.2a–7 of this chapter to file reports pursuant to § 270.30b1–6 of this chapter not later than two business days after the end of each month.

**Note:** The text of Form N–MFP will not appear in the Code of Federal Regulations.

### Form N–MFP—Monthly Schedule of Portfolio Holdings of Money Market Funds

Form N–MFP is to be used by open-end management investment companies, or series thereof, that are regulated as money market funds under § 270.2a–7 (''money market funds''), to file reports with the Commission, not later than the second business day of each month, pursuant to rule 30b1–6 under the Investment Company Act of 1940 (17 CFR 270.30b1–6). The Commission may use the information provided on Form N–MFP in its regulatory, disclosure review, inspection, and policymaking roles.

**General Instructions**

*A. Rule as to Use of Form N–MFP*

Form N–MFP is the public reporting form that is to be used for monthly reports of money market funds under section 30(b) of the Investment Company Act of 1940 (the ''Act'') and rule 30b1–6 of the Act (17 CFR 270.30b1–6). Form N–MFP must be filed no later than the second business day of each month, and will contain certain information about the money market fund and its portfolio holdings as of the last business day of the preceding month.

*B. Application of General Rules and Regulations*

The General Rules and Regulations under the Act contain certain general requirements that are applicable to reporting on any form under the Act. These general requirements should be carefully read and observed in the preparation and filing of reports on this form, except that any provision in the form or in these instructions shall be controlling.

*C. Filing of Form N–MFP*

A money market fund must file Form N–MFP no later than the second business day of each month, in accordance with rule 232.13 of Regulation S–T. Form N–MFP must be filed electronically using the Commission's EDGAR system.

*D. Paperwork Reduction Act Information*

A registrant is not required to respond to the collection of information contained in Form N–MFP unless the Form displays a currently valid Office of Management and Budget (''OMB'') control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to the Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. 3507.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM N–MFP—MONTHLY SCHEDULE OF PORTFOLIO HOLDINGS OF MONEY MARKET FUNDS

Date of Filing:
Report for [Month, Day, Year]
Name and Address of Fund or Portfolio Filing This Report:
CIK Number:
SEC File Number:
EDGAR Series Identifier:
Number of share classes offered:
Check here if Amendment [ ]
Amendment Number:
Is this an Initial Filing? [Y/N]
Is this a Final Filing? [Y/N]
Is the fund liquidating? [Y/N]
Is the fund merging with another fund? [Y/N]
If so, please identify the other fund by name, SEC File Number, and EDGAR Series Identifier.
Is the fund being acquired by another fund? [Y/N]
If so, please identify the acquiring fund by name, SEC File Number, and EDGAR Series Identifier.

**Part I: Information about the Fund**

Item 1. Name of Investment Adviser.
a. SEC file number of Investment Adviser.
Item 2. Name of Sub-Adviser. If a fund has multiple sub-advisers, disclose the name of all sub-advisers to the fund.
a. SEC file number of Sub-Adviser. Disclose the SEC file number of each sub-adviser to the fund.
Item 3. Independent Auditor.
Item 4. Administrator.
Item 5. Transfer Agent.
a. SEC file number of Transfer Agent.
Item 6. Minimum initial investment.
Item 7. Is this a feeder fund? [Y/N]
a. If this is a feeder fund, identify the master fund.
b. SEC File Number of the master fund.
Item 8. Is this a master fund? [Y/N]
a. If this is a master fund, identify all feeder funds.
b. SEC File Number of each feeder fund.
Item 9. Is this portfolio primarily used to invest cash collateral? [Y/N]
Item 10. Is this portfolio primarily used to fund variable accounts? [Y/N]
Item 11. Category. Indicate whether the money market fund is a Treasury, Government/Agency, Prime, Tax-Free National, or Tax-Free State Fund.
Item 12. Total value of the portfolio at cost, to the nearest hundredth of a cent.
Item 13. Net value of other assets and liabilities, to the nearest hundredth of a cent.
Item 14. Net asset value per share for purposes of distributions, redemptions, and repurchase, to the nearest hundredth of a cent.
Item 15. Net shareholder flow activity for the month ended (subscriptions less redemptions).
Item 16. Dollar weighted average maturity. Calculate the dollar

weighted average maturity of portfolio securities, based on the time remaining until the next interest rate re-set.

Item 17. Dollar weighted average life maturity. Calculate the dollar weighted average maturity of portfolio securities based on final legal maturity or demand feature.

Item 18. 7-day gross yield. Based on the 7 days ended on the last day of the prior month, calculate the Fund's yield by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one share at the beginning of the period and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then multiplying the base period return by (365/7) with the resulting yield figure carried to at least the nearest hundredth of one percent. The 7-day gross yield should not reflect a deduction of shareholders fees and fund operating expenses.

**Part 2: Schedule of Portfolio Securities. For each security held by the money market fund, please disclose the following:**

Item 19. The name of the issuer.

Item 20. CIK number of the issuer.

Item 21. The title of the issue.

Item 22. The CUSIP.

Item 23. Other unique identifier (if the instrument does not have a CUSIP).

Item 24. The category of investment. Please indicate the category that most closely identifies the instrument from among the following: Treasury Debt; Government Agency Debt; Variable Rate Demand Notes; Other Municipal Debt; Financial Company Commercial Paper; Asset Backed Commercial Paper; Certificate of Deposit; Structured Investment Vehicle Notes; Other Notes; Treasury Repurchase Agreements; Government Agency Repurchase Agreements; Other Repurchase Agreements; Insurance Company Funding Agreements; Investment Company; Other Instrument.

Item 25. Rating. Please indicate whether the security is a 1st tier security, unrated, or no longer eligible.

Item 26. Requisite NRSROs.

a. Identify each Requisite NRSRO.

b. For each Requisite NRSRO, disclose the credit rating given by the Requisite NRSRO.

Item 27. The maturity date as determined under rule 2a–7. Disclose the maturity date, taking into account the maturity shortening provisions of rule 2a–7.

Item 28. The final legal maturity date.

Item 29. Is the maturity date extendable? [Y/N]

Item 30. Does the security have a credit enhancement? [Y/N]

Item 31. For each credit enhancement, disclose:

a. The type of credit enhancement.

b. The identity of the credit enhancement provider.

c. The credit rating of the credit enhancement provider.

Item 32. Does the security have an insurance guarantee? [Y/N]

Item 33. For each insurance guarantee provider, disclose:

a. The identity of the insurance guarantee provider.

b. The credit rating of the insurance guarantee provider.

Item 34. Does the security have a liquidity provider? [Y/N]

Item 35. For each liquidity provider, disclose:

a. The identity of the liquidity provider.

b. The credit rating of the liquidity provider.

Item 36. The principal amount of the security.

Item 37. The current amortized cost, to the nearest hundredth of a cent.

Item 38. Is this a Level 1, Level 2, or Level 3 security, or Other? Please explain how the security was valued. Level 1 securities are valued based on quoted prices in active markets for identical securities. Level 2 securities are valued based on other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risks, etc.). Level 3 securities are valued based on significant unobservable inputs (including the fund's own assumptions in determining the fair value of investments). *See* Statement of Financial Accounting Standards Board No. 157, ''Fair Value Measurement.''

Item 39. The percentage of the money market fund's gross assets invested in the security, to the nearest hundredth of one percent.

Item 40. Explanatory notes. Please disclose any other information that may be material to other disclosure in the Form.

Dated: June 30, 2009.

By the Commission.

**Elizabeth M. Murphy,**

*Secretary.*

[FR Doc. E9–15906 Filed 7–7–09; 8:45 am]

BILLING CODE 8010–01–P