

# TACKLING THE MONEY MARKET REFORM

**A framework for broker-dealers to assess the impacts and develop a strategy to comply with the reform**

## **Industry Insight Series**

Gartland & Mellina Group

October 2014

“Today’s reforms fundamentally change the way that money market funds operate. They will reduce the risk of runs in money market funds and provide important new tools that will help further protect investors and the financial system. Together, this strong reform package will make our markets more resilient and enhance transparency and fairness of these products for America’s investors.”

—SEC Chair Mary Jo White, July 23, 2014

Yet, what does this really mean for broker-dealers and their clients? Following the approval of the 2014 money market reform by the SEC, broker-dealers must begin to understand the fundamental changes to the regulatory structure of money market funds that will require comprehensive modifications to the way these funds are processed from both an operational and a technological perspective. Now is the time to focus on how these changes impact clients, how those clients will react and if there is a need to modify fund offerings.

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# WHAT CAN BE DONE TO BETTER PREPARE?

This reform is in addition to the amendments in 2010 to Rule 2A-7 around liquidity, quality, and reporting requirements including changes to the allowable weighted average life of portfolio holdings of money market funds. Many have argued that those reforms did not go far enough to curb systematic risk. After 5 years of debate between the financial regulators (Financial Stability Oversight Committee) and the SEC for more comprehensive reform to reduce susceptibility to runs and systemic risk, the SEC issued a ruling that fundamentally alters money market fund regulation.

This paper highlights the reform passed by the Securities and Exchange Commission (SEC) on July 23, 2014 and discusses some of the key impacts of the reform to broker-dealers and their clients including potential costs, timing and next steps.

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The time is now for broker-dealers to assess the potential impact on products, platforms and operations to create a well-thought-out implementation plan to comply with the reform.

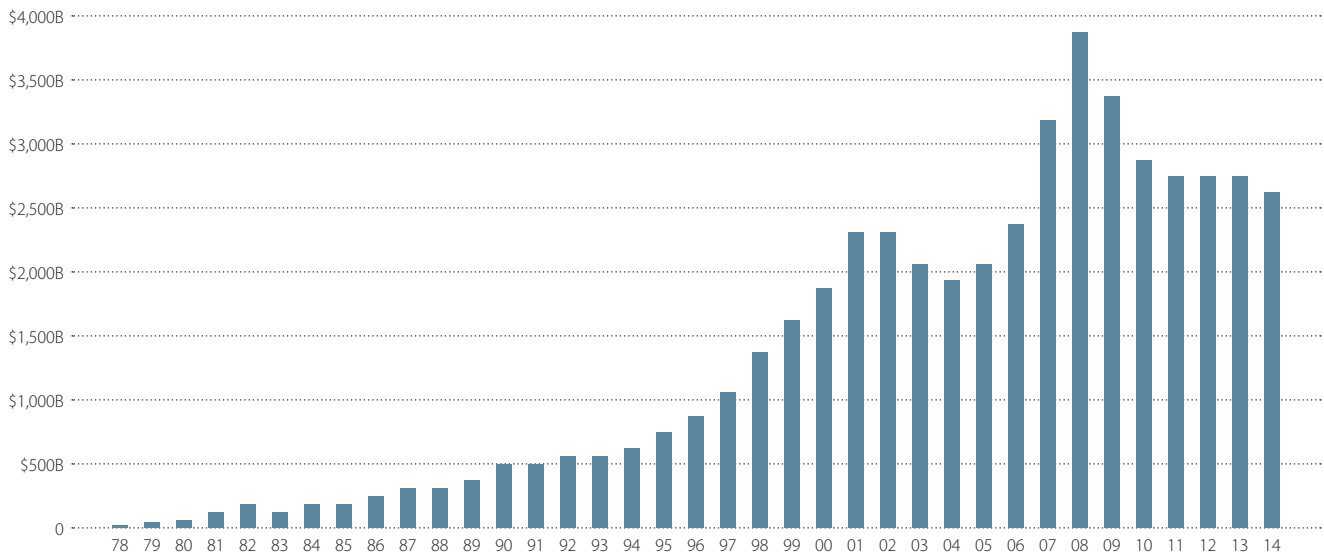
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# A HISTORY OF MONEY MARKET FUND REFORM

The 2008 financial crisis and the bankruptcy of Lehman Brothers led to the net asset value (NAV) of the Reserve Primary Fund “breaking the buck” and falling to \$0.97. This resulted in significant redemptions from prime institutional funds as investors fled the market and invested instead in retail funds. On September 19, 2008, the U.S. Department of Treasury temporarily guaranteed the \$1.00 share price of more than \$3 trillion in money market fund shares and the Board of Governors of the Federal Reserve System created facilities to support the short-term markets. In 2010, in response to the events of 2008, the SEC took steps to improve the resiliency and stability of money market funds against systemic risk by adopting amendments to rule 2a-7 of the Investment Company Act of 1940. These changes include:

- Portfolio maturity and liquidity requirements
- Disclosure of portfolio holdings and shadow pricing requirements
- Procedures surrounding funds breaking a dollar or about to break a dollar
- Stress testing

## Annual Money Fund Assets (1978-2014)



Source: ICI, Crane Data

Despite the amendments to rule 2a-7 which made money market funds better able to withstand heavy redemptions, a view persisted that additional regulation was required to address the structural vulnerabilities that continue to leave money market funds susceptible to large scale redemptions or runs and the stable value pricing structure that resulted in the 2008 run. As a result, in 2013, the SEC proposed two alternative reforms that could also be adopted in combination. Those reforms were a “floating NAV” for institutional prime funds and permissible liquidity fees and redemption gates. After consideration of the approximately 1,400 comments received on the proposal, on July 23, 2014, the SEC voted 3-2 in favor of adopting the following money market reforms.



# TODAY'S CRITICAL CHANGES

## Floating the NAV

Per the SEC, the goal of a floating NAV is to provide greater transparency to shareholders, thus reducing the risk/incentive of a run on the fund in the event of a downturn in market value. It is believed that the amortized cost valuation creates susceptibility to runs as losses are not recognized until the market value decreases by ½%, creating an incentive “cliff” for redemptions if shareholders believe the market value is falling significantly enough below the amortized cost calculation.

Per the SEC, the floating NAV amendments are designed to reduce the first mover advantage inherent in a stable NAV fund by disincentivizing redemption activity that can result from investors attempting to exploit the possibility of redeeming shares at the stable share price even if the portfolio has suffered a loss. They are also intended to reduce the chance of unfair investor dilution and make it more transparent to certain impacted investors that they, and not the fund sponsors or the federal government, bear the risk of loss.

## Key Aspects of the Floating NAV Amendments

**1** Institutional prime money market funds will no longer be able to use amortized cost to value their portfolio securities. Daily share prices of these money market funds will be required to abandon their fixed \$1 value and fluctuate along with changes in the market-based value of their portfolio securities like other mutual funds.

**2** Institutional prime money market funds will be required to price their shares using a more precise method so that investors are more likely to see fluctuations in value. Currently, money market funds “penny round” their share prices to the nearest one percent (to the nearest penny). Under the floating NAV amendments, institutional prime money market funds instead will be required to “basis point round” their share price to the nearest 1/100th of one percent. As opposed to the value decrease of ½% that was previously required to recognize losses, the share price of these funds will now change with a value decrease of 1/200%.

**3** Government and retail money market funds are exempt as long as they meet the below guidelines:

Government Funds: Must invest at least 99.5% of assets in cash, government securities and/or repurchase agreements that are collateralized solely by government securities or cash.

Retail Funds: Must have policies and procedures designed to limit beneficial owners to natural persons.

**4** A capital (or tax-exempt) fund would be required to transact with a floating NAV unless the fund meets the definition of a retail money market fund, in which case it would be allowed to use the amortized cost method and/or penny rounding method of pricing to seek to maintain a stable share price.

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Firms seeking to avoid the requisite system changes and enhancements required to support the reform by not offering impacted funds should consider the additional risk if a non-impacted fund “breaks the buck.”

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## Liquidity Fees and Redemption Gates

The SEC will adopt a new liquidity fee and gate regime to give fund boards a new tool to directly address runs. The rules will allow money funds to temporarily block investors from withdrawing their money in times of stress, or allow the funds to impose a fee to redeem shares.

### Key Aspects of Liquidity Fees and Redemption Gates Amendments

**1** Liquidity Fee – A liquidity fee of up to 2% may be imposed if the fund's weekly liquid assets fall below 30% of total assets. Such a fee could be imposed only if the money market fund's board of directors determines that such a fee is in the best interests of the fund. If the weekly liquid assets fall below 10%, the money market fund is required to impose a 1% fee unless the board determines that a fee is not in the best interest of fund.

**2** Redemption Gate – If a money market fund's level of weekly liquid assets falls below 30%, a money market fund's board could in its discretion temporarily suspend redemptions. In order to impose a gate, the money market fund's board of directors would need to deem that it was in the best interest of the fund. The maximum length was decreased to 10 business days (down from 30 days under proposed rule) and gates may not be imposed for more than 10 business days in any 90-day period.

**3** Fees/gates must be removed if weekly liquid assets increase above 30% of total assets. Weekly liquid assets generally include cash, U.S. Treasury securities, certain other government securities with remaining maturities of 60 days or less, and securities that convert into cash within one week.

**4** Government money market funds would not be subject to the new fees and gates provisions. However, these funds could voluntarily opt into them, if previously disclosed to investors.

Other reforms in the package include enhanced disclosure requirements, immediate reporting of fund portfolio holdings, improved private liquidity fund reporting, stronger diversification requirements, enhanced stress testing, and a proposal on removal of credit references which will be finalized in advance of the compliance dates.

Please see the appendix for a more detailed view on each of these items.

### Compliance Dates & Timing

The amendments become effective October 14, 2014. As of this date, funds may begin complying with the regulation. The SEC has provided a two year conformance period for the key changes (floating NAV and liquidity fees/gates), although there are shorter compliance periods for the other changes (e.g., disclosures, stress testing, etc.):

 **July 14, 2015**

The compliance date for a new form N-CR and related website disclosure

 **April 14, 2016**

The compliance date for the amendments to diversification, stress testing, disclosure, Form PF, Form N-MFP and clarifying amendments

 **October 14, 2016**

The compliance date for floating NAV, liquidity fees and gates amendments

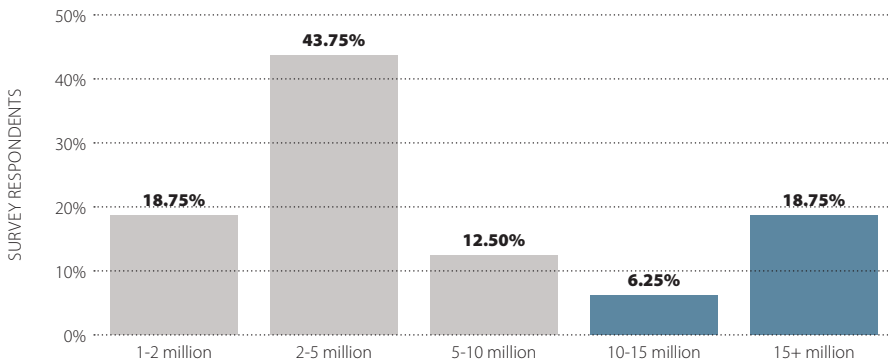
# WHAT'S AT STAKE FOR BROKER DEALERS?

The impacts of the reform are far-reaching for broker-dealers who have built not only their money market fund supporting infrastructure and processing systems around the assumption that these funds will always be priced at \$1.00, but their operational policies and procedures as well.

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The operational and technological changes required will permeate layers of processing that currently support money market funds and would infiltrate areas that have previously excluded money market funds. As evidenced by the response to a 2013 SIFMA survey of broker-dealers, many are expecting large time and cost expenditures to develop and implement modified procedures, controls and systems to support money market funds under the regulation.

## Implementing the Floating NAV



### Initial Cost to Implement Floating NAV

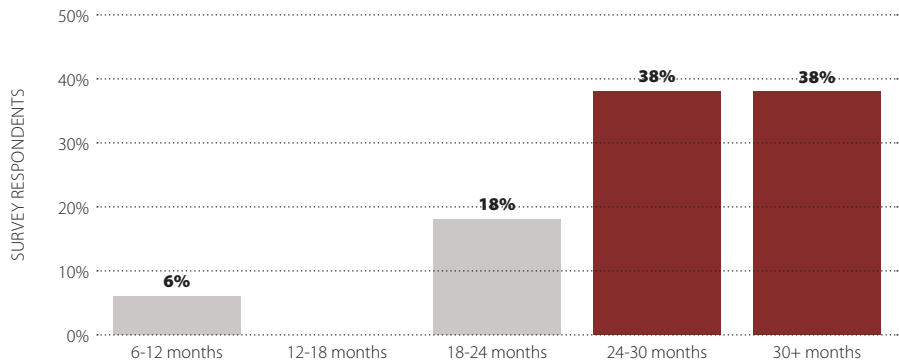
**25%**

of broker-dealers responding to the SIFMA survey anticipate initial cost to modify procedures, controls and systems associated with implementing a floating NAV to exceed \$10 million

### Timeframe to Implement Floating NAV

**76%**

of broker-dealers responding to the SIFMA survey anticipated the timeline associated with implementing a floating NAV to exceed the 2 year deadline provided by the SEC.



Source: SIFMA Money Market Proposal Impact Survey Results

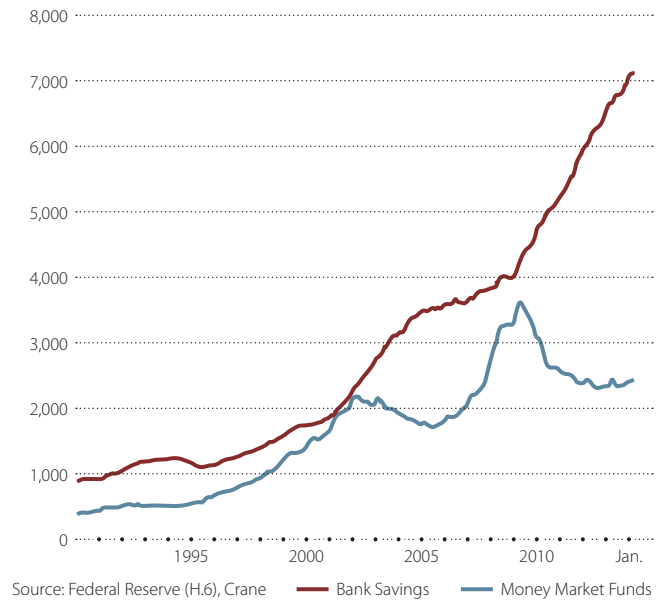
**The State of the Industry Today**

Since 2010, the overall money market fund industry has seen a decline in assets, while bank deposits have simultaneously experienced growth in assets. One possible explanation for this dynamic is that a combination of the economic downturn in 2008 and the introduction of new regulation in 2010 drove money market yields down to levels more comparable to bank deposits. Without the benefit of a higher yield, and given that bank deposits have the added benefit of insurance, the landscape has been shifted in favor of bank deposits.

**Changing the Shift in Demand**

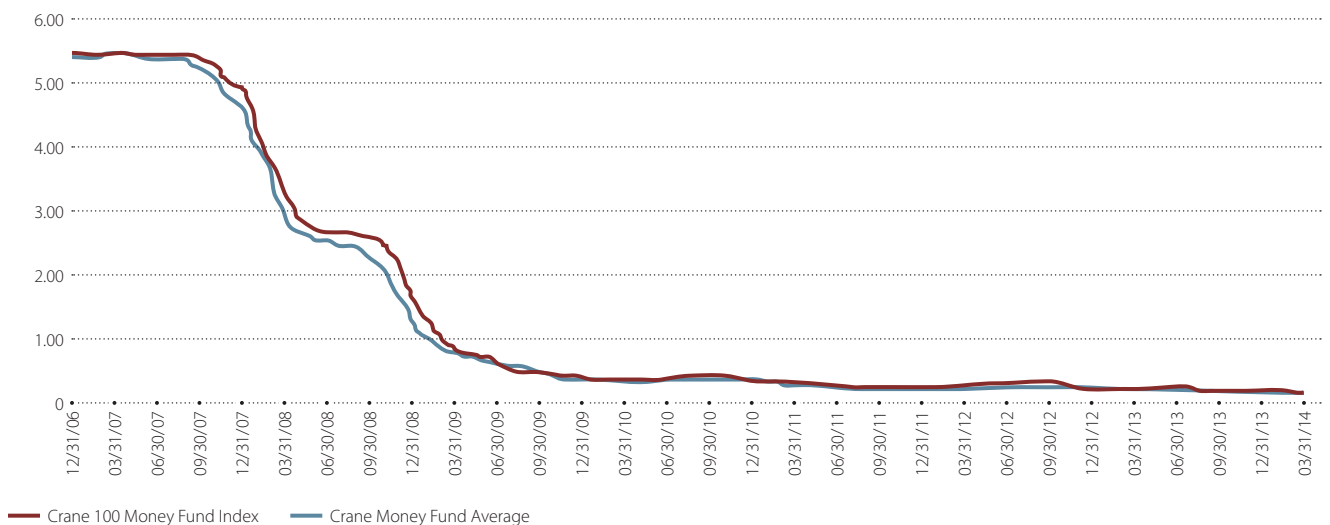
If the spread between money market funds yields and bank deposits returns to prior levels, it would be expected that there would be an increased demand for money market funds. However, given the SEC implementation of reform requiring a floating NAV and redemption gates/liquidity fees, it is unclear how the market will react. Will investors continue to see prime institutional money market funds as an attractive investment for liquid assets due to higher yields? Or, will investors find that the reform removes the safety of “preservation of capital” and limits liquidity, two fundamental aspects of money market funds?

**Significant Change in the Movement of Assets (Bank Savings vs. Money Market Funds)**



Will investors continue to see prime institutional money market funds as an attractive investment for liquid assets due to higher yields? Or, will investors find that the reform removes the safety of “preservation of capital” and limits liquidity, two fundamental aspects of money market funds?

**Battling Near Zero Yields**



## HOW THE REFORM AFFECTS YOUR CLIENTS

A wide variety of investors use money market funds, primarily because of the product's liquidity and stable NAV. Funds, broker-dealers, intermediaries, and service providers have developed a wide array of arrangements for distributing and using money market funds efficiently. Many of these arrangements are drastically impaired by the money market funds reform, even under normal market conditions.

**Institutional investors**, including corporations of all sizes, state and local governments, securities lending operations, bank trust departments, securities brokers, and investment managers, use money market funds as a cost-effective way to manage and diversify credit risk, while providing same-day liquidity with market-based yields. These investors often use money market funds as a temporary holding vehicle for cash to facilitate transactions for capital expenditures and day-to-day operations, including payroll. Similarly, trust account arrangements use money market funds on a short-term basis pending other activity, such as securities' transaction settlements, beneficiary expenses, real estate transactions, and other beneficiary related distributions.

**Sweep programs** offered by brokerage firms, banks, and trading platforms use money market funds to invest cash held in customer accounts. Like institutional accounts, sweep vehicles hold investor cash on a temporary basis; customers intend to use this cash primarily to fund trading activity conducted in their accounts. Sweeps are initiated by intermediaries at the end of the day. Typically, after all other transactions for the day have been posted, the total remaining collected balances (or all available

cash) in customer accounts are invested in (swept into) money market funds.

**Retail investors** often use money market funds to temporarily hold cash from redemption transactions on their long-term mutual funds. Cash in money market funds may also be used to fund future purchase transactions (through exchanges or other reinvestment transactions) or to pay ongoing expenses (using both check-writing and debit-card functionality) and future (planned) expenditures, including tuition and education related expenses.

**Retirement account investors** may choose to invest a portion of their tax-advantaged retirement assets in money market funds. These investments are often temporary in nature and used to fund other investment transactions. In other cases, retired investors use assets in money market funds to support ongoing expenses. As fiduciaries, retirement plan sponsors may be barred from offering money market funds that are subject to redemption restrictions to plan participants. Such restrictions would also impair the features and liquidity of money market funds that retirees, along with other retail investors, rely upon and value.

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Financial intermediaries must now incur the costs of investing in enhancements to support floating NAV money market funds and the infrastructure to implement redemption fees and gates. In order to better understand the impacted areas and the costs associated with them, we have broken down the impacts at a high level from a product, operational and technology perspective.



The reform will also immediately impact products and platform structure from both a retail and an institutional perspective and may result in a significant change in the way money market funds and sweep programs are used. Specific impacts include:

- Preservation of Capital - The increased risk of price fluctuation would impact the perception of money funds as an instrument for preservation of capital and would be likely to result in outflows from money market funds subject to floating NAV.
- Buying/Spending Power - Subjecting money market funds to a floating NAV would undermine the ability to use invested funds as a cash equivalent. Buying/spending power would be either inflated or understated based on the previous day's NAV in the event of a price fluctuation. A downward fluctuation in the NAV would cause the clients buying/spending power to be overstated if calculated based on the previous day's NAV and could result in a margin debit. Firms would need to consider removing floating NAV money market funds from buying/spending power calculations or implementing a percentage "buffer" in cash available calculation.
- Product Demand - In the current rate environment, regulation that imposes a floating NAV on money market funds would be expected to drive demand for those funds lower. In the past three years, money market funds are down 18.7% while bank savings are up 38.4%. Prime institutional funds comprise 32% of money market fund assets (\$802 billion).
- Retail Fund Exemption - Broker-dealers may need to consider additional suitability requirements for identifying "natural persons", tracking and reporting of investor classification information, frequency of attestation and the potential for forced redemptions in the event of a suitability violation.
- Sweep Vehicles - Impacted funds may be deemed unsuitable as sweep vehicles which could require mapping/bulk transfers of assets to funds that will continue to be offered as sweep options.

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## Broker-dealers considering sweep menu changes must assess fund mapping and bulk transfers of assets.

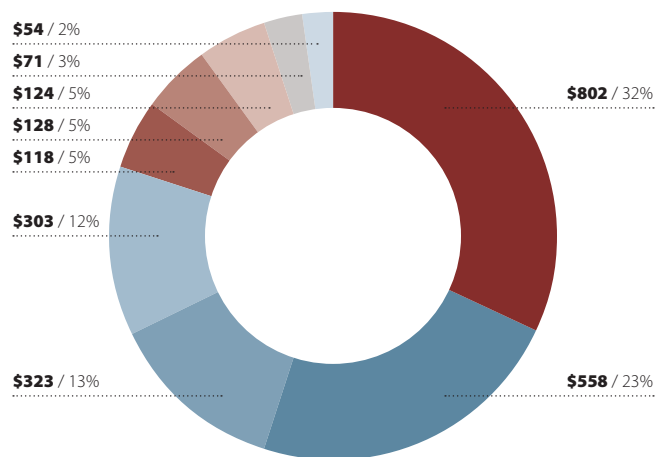
### Assets in Money Market Funds\*

Prime institutional funds make up about 32% of money-market funds; prime retail funds account for about 23%.

- Prime Institutional
- Prime Retail
- Treasury Institutional
- Government Institutional
- Treasury Retail
- Government Retail
- Tax-exempt Retail
- State Tax-exempt
- Tax-exempt Institutional

\*As of June 30, 2014.  
All figures are billions. Total money market fund assets: \$2.48 Trillion.

Source: Crane Data LLC



## OPERATIONAL & TECHNOLOGICAL IMPACTS

A summary of the major operational and technological impacts include changes or enhancements of the firm's books and records process, pricing, money market/mutual fund processing, reconciliation, and surveillance. Additionally, impacted downstream systems and processes include advisory desktop tools, performance reporting, statements, tax reporting, gain/loss, confirms and disclosures.

### The Challenges of a Floating NAV

- Same-day settlement is predicated on the basis of a stable share price, and would be a challenge to support for impacted funds unless fund companies consider intra-day pricing. The challenges of intra-day pricing include the ability of broker-dealers to support multiple transmissions to funds, increasingly complex reconciliation and the potential for multiple intra-day settlements. A floating NAV fund seeking same-day settlement will require intra-day and nightly pricing thereby limiting the window to settle trades.
- A floating NAV would add complexity to reconciliation, trade exception and correction processing that does not exist for money market funds today. The functions now must provide the same level of service to floating NAV money market funds as they do to all mutual funds. Floating NAV money market funds will need to be operationally and technologically incorporated into these processes.
- Exact settlement dollars will not be known at order entry and settlement funds may fall short, requiring deposit. Investors utilizing floating NAV money market funds for transaction settlements and other expenses incur the risk of the value of their holding falling below the settlement or debit amount. Broker-dealers will need to determine how to enforce cash available checks prior to transactions. Clients using a floating NAV money market fund as their sweep option run the risk of having their debit card and online payments rejected.
- The volume of money market trading will add to tax lot accounting and tax reporting for brokerage and client. While the Treasury and IRS have stated that they will allow for simplified accounting methods to be used and relief from the "wash rule", alleviating the need to track individual buy and sell transactions, enhanced tax treatment and record keeping may be required for floating NAV funds.
- New logic would be needed to automate dollar sell orders as systems can no longer assume a static \$1 price. Enhancements, and additional validation (as mentioned above), would be required in order to allow for dollar amount redemptions in floating NAV money market funds due to the fluctuating value of shares.
- Impacted platforms need to be analyzed and potentially re-coded to accurately use dollar value or share amount as necessary as there would no longer be a 1-to-1 interchangeable relationship between the dollar value and share amount.

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Same-day settlement is predicated on the basis of a stable share price and will be a challenge to support for impacted funds unless fund companies consider intra-day pricing.

### **The Challenges of Liquidity Fees and Redemption Gates**

Fees and gates effectively remove the liquidity utility of money market funds. If a fee or gate is imposed, it places a greater risk on retail investors who are less likely to have alternate funding choices:

- Interfaces will be needed between fund companies and broker-dealers to facilitate communication of liquidity fees or gates. Broker-dealers and fund companies will require a means for sending and receiving messages containing fee/gate information.
- Implementation of a mechanism to capture liquidity fee amounts or gate impositions and impose them. If fund companies are permitted to implement fees/gates mid-day, broker-dealers will need to consider the ability to timestamp trade activity.
- A gate would interrupt settlement of other purchases making impacted funds unreliable sweep options.
- A redemption fee has similar effect on availability as a floating NAV for settlement and cash management accounts.
- Increased monitoring to ensure accurate imposition of fee/gate.
- A liquidity fee would add complexity to reconciliation, trade exception and correction process similar to the effect of a floating NAV on these processes.
- New logic would be needed to automate dollar sell orders. In addition to the calculation and validation discussed above for floating NAV, in the event a liquidity fee is imposed on a fund, a calculation and validation will be needed to account for that fee amount when accepting a dollar sell order.

Additional changes include client disclosure language that would need to be updated to reflect the regulation and increased cost to print and mail client statements and confirmations.

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Interfaces will be needed between fund companies and broker-dealers to facilitate communication of liquidity fees or gates.

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# BUILDING YOUR STRATEGY

In light of the above impacts, where should broker-dealers start to assess and implement the potential changes required to their organization to comply with the reform? The following approach provides a framework that broker-dealers can apply to better understand the impacted areas and potential changes and then develop and execute a strategy on how to meet the requirements of the reform:

## The 4-Step GMG Framework

### 1. Impact Assessment

- Firms should begin by reviewing their current money market ticketed and sweep products/funds impacted by the reform. This includes metrics such as assets under management (AUM) and flows in and out of the funds.
- Review and document the current state from both an operational and technology perspective to understand all the various touch points in the process.
- Identify all the impacted functions/systems, determine processing changes and estimated costs required to comply with the reform.

### 2. Define Strategy and Target State

- Based on the impact assessment, firms will have a view into all the impacted areas and the costs involved in meeting the requirements of the reform including migration costs to the target state environment.
- Firms will need to make a decision around product offerings and determine if they choose to offer funds impacted by the reform. Firms electing not to offer funds impacted by the reform in order to avoid the requisite system changes and enhancements could be taking on additional risk in the event a non-impact fund “breaks the buck” in the future.
- Define comprehensive target operating model including finalized product offerings.

### 3. Implementation Roadmap

- Firms should identify and prioritize all the changes required in accordance with the conformance period for the key changes.
- Build implementation road map with key initiatives, milestones, dependencies, interdependencies, and associated impact on target operating model.

### 4. Planning and Execution

- Identify requirements and build support structure as mandated by the SEC for systems enhancements, literature updates, operational processes.
- Develop a testing strategy and plan to test all the end-to-end rollout of strategic solution (e.g. systems developments, print vendors).
- Develop and execute client/ field/ business communications strategy.

# THE GARTLAND & MELLINA EXPERIENCE

Gartland & Mellina Group has been following the money market reform for over two years. We have conducted impact assessments across multiple clients from an operations, technology and product perspective to identify the impacted areas and the potential costs of modifications and enhancements required to comply with the regulation. GMG has also assisted firms in conducting market research and analysis with their financial advisors and client bases to assess the appropriate money market product suite in the new regulatory environment.

Additionally, GMG has vast experience in leading large-scale implementations to support the build-out of mutual fund and money market processing platforms across multiple institutions and vendors. GMG has helped clients in analyzing competing platforms and systems, as well as opined on vendor build/buy decisions and implementations. With an average of 18+ years of project management experience and industry expertise, our wealth and investment management team is well-versed in planning and executing on all phases of the systems development life cycle (SDLC).

We welcome a conversation to better understand the challenges your organization is facing with respect to complying with the recent reform and assess how we can assist. Please feel free to contact us for further discussion or a request for our qualifications.

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# APPENDIX

In addition to floating NAV and liquidity fees and gates, the SEC has also outlined additional requirements within the money market reform passed on July 23, 2014:

## Enhanced Disclosure Requirements

1. Website Disclosure – Money market funds will be required to disclose on their website, on a daily basis, their levels of daily and weekly liquid assets, net shareholder inflows or outflows, market-based NAVs per share, imposition of fees and gates, and any use of affiliate sponsor support.
2. New Material Event Disclosure – Money market funds will be required to promptly disclose certain events on a new Form N-CR. These events would include the imposition or removal of fees or gates and the primary considerations or factors taken into account by a board of directors in its decision related to fees and gates; portfolio security defaults; sponsor or fund affiliate support, including the amount of support and a brief description of the reason for support; and—for retail and government funds—a fall in the fund's market-based NAV per share below \$0.9975.
3. Disclosure of Sponsor Support – Money market funds will be required to provide in their statements-of-additional-information (SAIs) disclosure regarding any occasion during the last 10 years (but not for occasions that occurred before the compliance date) in which the money market fund received sponsor or fund affiliate support. This disclosure would be in addition to the current-event disclosures required on Form N-CR.

## Immediate Reporting of Fund Portfolio Holdings

Money market funds currently report detailed information about their portfolio holdings to the SEC each month on Form N-MFP. The rules amend Form N-MFP to clarify existing requirements and require reporting of additional information relevant to assessing money market fund risk. In addition, the final rules would eliminate the current 60-day delay on public availability of the information filed on the form and make it public immediately upon filing.

## Improved Private Liquidity Fund Reporting

To better monitor whether substantial assets migrate to private "liquidity funds" in response to money market fund reforms, the rules amend Form PF, which private fund advisers use to report information about certain private funds they advise.

The rules require a large liquidity fund adviser (a liquidity fund adviser managing at least \$1 billion in combined money market

fund and liquidity fund assets) to report substantially the same portfolio information on Form PF as registered money market funds are required to report on Form N-MFP. A liquidity fund is essentially an unregistered money market fund.

## Stronger Diversification Requirements

The rules also include the following changes to the diversification requirements for money market funds' portfolios:

1. Aggregation of Affiliates – Money market funds will be required to treat certain entities that are affiliated with each other as single issuers for purposes of determining whether they are complying with money market funds' five percent issuer diversification limit. Under this limitation, a fund generally could not invest more than five percent of its assets in any one issuer, or group of affiliated issuers.
2. Removal of the 25 Percent Basket – For money market funds other than tax-exempt money market funds, the rules will require that all of a money market fund's assets meet the 10 percent diversification limit for guarantors and demand feature providers, thereby removing the so-called 25 percent basket that permitted as much as 25 percent of the value of securities held in a money market fund's portfolio to be subject to guarantees or demand features from a single institution. For tax-exempt money market funds (also referred to as capital money market funds), the 25 percent guarantor basket would be reduced to 15 percent so that no more than 15 percent of the value of securities held in a tax-exempt money market fund's portfolio could be subject to guarantees or demand features from a single institution.
3. Asset-Backed Securities – Money market funds will be required to treat the sponsors of asset-backed securities as guarantors subject to the 10 percent diversification limit applicable to guarantees and demand features, unless the money market fund's board of directors (or its delegate) determines that the fund is not relying on the sponsor's financial strength or its ability or willingness to provide liquidity, credit or other support to determine the asset-backed security's quality or liquidity.

## Enhanced Stress Testing

The rules will further enhance the stress testing requirements adopted by the SEC in 2010. In particular, a money market fund will be required to test its ability to maintain weekly liquid assets of at least 10 percent and to minimize principal volatility in response to certain specified hypothetical stress scenarios. In addition, the SEC would be adopting modifications to the current reporting requirements to boards of directors regarding stress testing aimed at improving the quality of reports the boards receive.

### **Removal of References to Credit Ratings and Amendment to Issuer Diversification Provisions**

In addition to the broad reforms to money market fund regulation discussed above, the SEC re-proposed amendments to rule 2a-7 and Form N-MFP to address provisions that reference credit ratings. The SEC will also propose an amendment to the issuer diversification provisions of rule 2a-7.

#### **Re-proposed Ratings Removal**

The re-proposed amendments will implement section 939A of the Dodd-Frank Act, which requires the SEC to remove any reference to or requirement of reliance on credit ratings in its regulations and to establish appropriate standards of creditworthiness in place of certain references to credit ratings in SEC rules. Currently, to ensure that these funds are invested in high quality short-term securities, rule 2a-7 requires that money market funds invest only in securities that have received one of the two highest short-term ratings (that is, are rated either “first tier” or “second tier”) or if they are not rated, are of comparable quality.

It also currently requires that a money market fund invest at least 97 percent of its assets in first tier securities. In addition, rule 2a-7 requires that a fund’s board of directors (or its delegate) determine that the security presents minimal credit risks. This determination

must be based on factors pertaining to credit quality in addition to any rating assigned to the security.

1. Credit Quality Determinations for Money Market Fund Portfolio Securities – The re-proposed amendments to rule 2a-7 will eliminate the credit ratings requirements for money market funds. Instead, a money market fund could invest in a security only if the fund’s board of directors (or its delegate) determines that it presents minimal credit risks, and that determination would require the board of directors to find that the security’s issuer has an exceptionally strong capacity to meet its short-term obligations.

2. Amendments to Form N-MFP – Currently money market funds report their portfolio holdings and other information to the Commission each month on Form N-MFP, including certain credit ratings assigned to each portfolio security. The re-proposed amendments to Form N-MFP will require that a money market fund disclose any credit rating that the fund’s board considered in determining that a portfolio security presents minimal credit risk.

#### **Proposed Issuer Diversification Exclusion**

The proposed amendment to rule 2a-7 will eliminate an exclusion from the issuer diversification provisions for securities with certain guarantees.