FACT SHEET

Reforming Money Market Funds

SEC Open Meeting
June 5, 2013

The Securities and Exchange Commission today will consider whether to propose rules that would reform the way that money market funds operate.

Background

The History of Money Market Funds – Money market funds are a type of mutual fund developed in the 1970s as an option for investors to purchase a pool of securities that generally provided higher returns than interest-bearing bank accounts. They have since grown significantly and currently hold more than $2.9 trillion in assets, the majority of which is in institutional funds.

Under Investment Company Act Rule 2a-7, these funds must limit their portfolio investments to high-quality, short-term debt securities. Unlike other mutual funds, money market funds seek to maintain a stable share price (typically $1.00) through the use of certain valuation and pricing methods permitted under Rule 2a-7. The typical experience for a money market fund investor is that when they invest a dollar, they are able to get back a dollar on demand (plus the yield that was earned during the course of the investment). As a result, money market funds have become popular cash management vehicles for retail and institutional investors.

When a money market fund’s market-based value deviates more than 0.5 percent ($0.005) from its stable $1.00 share price, a money market fund generally re-prices at its market value. At these times, investors will no longer get back their full dollar – a phenomenon known as “breaking the buck.”

There are many kinds of money market funds, including ones that invest primarily in government securities, tax-exempt municipal securities, or corporate debt securities. Money market funds that primarily invest in corporate debt securities are referred to as prime funds.

Funds are often structured to cater to different types of investors. Some funds are marketed to individuals and intended for retail investors, while other funds that typically require very high minimum investments are intended for institutional investors.

The Financial Crisis – At the height of the financial crisis in September 2008, a money market fund named the Reserve Primary Fund “broke the buck” and re-priced its shares below its $1.00 stable share price, leading many investors to pull their money out of the fund. That same week, prime institutional money market funds experienced rapid heavy redemptions, with investors withdrawing approximately $300 billion (14 percent of their assets). These redemptions, which halted after the U.S. Treasury provided a government guarantee, prompted the SEC to evaluate the need for money market fund reform.
The 2010 Amendments – In March 2010, the Commission adopted a series of amendments to its rules on money market funds. The amendments were designed to make money market funds more resilient by reducing the interest rate, credit, and liquidity risks of their portfolios. Although these reforms improved money market fund resiliency, the Commission said at the time that it would continue to consider whether further, more fundamental changes to money market fund regulation might be warranted.

Study by the Division of Risk, Strategy, and Financial Innovation – In December 2012, staff from the SEC’s Division of Risk, Strategy, and Financial Innovation published a study relating to money market funds. The study contained, among other things, a detailed analysis of the possible causes of investor redemptions in prime money market funds during the 2008 financial crisis, certain characteristics of money market funds before and after the Commission’s 2010 reforms, and how future reforms of money market fund regulation might affect investor demand for money market funds and alternative investments.

The study indicated that government money market funds generally are not susceptible to heavy redemptions or runs due to the nature of their portfolio assets. Retail investors have historically been less likely to redeem heavily from such funds in times of financial stress.

The study informed the Commission’s consideration of the risks that may be posed by money market funds and provided a foundation for this proposal.

The Proposal

The Commission is considering a proposal that would include two principal alternative reforms that could be adopted alone or in combination. The proposal also includes additional diversification and disclosure measures that would apply under either alternative.

The proposed reforms are designed to:
- Mitigate money market funds’ susceptibility to heavy redemptions during times of stress.
- Improve money market funds’ ability to manage and mitigate potential contagion from high levels of redemptions.
- Preserve as much as possible the benefits of money market funds for investors and the short-term financing markets.
- Increase the transparency of risk in money market funds.

Alternative One: Floating NAV – Under the first alternative, prime institutional money market funds would be required to transact at a floating net asset value (NAV), not at a $1.00 stable share price. The floating NAV alternative is designed primarily to address the heightened incentive shareholders have to redeem shares in times of financial stress. It also is intended to improve the transparency of money market fund risks through more visible valuation and pricing methods.

- Floating the NAV – Prime institutional money market funds would no longer be able to use amortized cost to value their portfolio securities except to the limited extent all mutual funds are able to do so. Daily share prices of these money market funds would
fluctuate along with changes, if any, in the market-based value of their portfolio securities.

- **Showing Fluctuations in Price** – Under the first alternative, prime institutional money market funds would 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 price to the nearest one percent (to the nearest penny in the case of a fund with a $1.00 share price). Under the floating NAV proposal, prime institutional money market funds instead would be required to “basis point round” their share price to the nearest 1/100th of one percent (the fourth decimal place in the case of a fund with a $1.0000 share price).

- **Exempting Government and Retail Money Market Funds** – Government and retail money market funds would be allowed to continue using the penny rounding method of pricing and maintain a stable share price. A government money market fund would be defined as any money market fund that holds at least 80 percent of its assets in cash, government securities, or repurchase agreements collateralized with government securities. A retail money market fund would be defined as a money market fund that limits each shareholder’s redemptions to no more than $1 million per business day.

**Alternative Two: Liquidity Fees and Redemption Gates** – Under the second alternative, money market funds would continue to transact at a stable share price, but would be able to use liquidity fees and redemption gates in times of stress.

- **Liquidity Fees** – If a money market fund’s level of “weekly liquid assets” were to fall below 15 percent of its total assets (half the required amount), the money market fund would have to impose a 2 percent liquidity fee on all redemptions. However, such a fee would not be imposed if the fund’s board of directors determines that such a fee is not in the best interest of the fund or that a lesser liquidity fee is in the best interest of the fund. 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.

- **Redemption Gates** – Once a money market fund had crossed this threshold, its board of directors also would be able to impose a temporary suspension of redemptions (or “gate”). A money market fund that imposes a gate would need to lift that gate within 30 days, although the board of directors could determine to lift the gate earlier. Money market funds would not be able to impose a gate for more than 30 days in any 90-day period.

- **Prompt Public Disclosure** – Money market funds would be required to promptly and publicly disclose the fund crossing of the 15 percent weekly liquid asset threshold, the imposition and removal of any liquidity fee or gate, and a discussion of the board’s analysis in determining whether or not to impose a fee or gate.

- **Exemption for Government Money Market Funds** – Government money market funds would be exempt from the fees and gates requirement. However, these funds could voluntarily opt into this new requirement.

**Potential Combination of Both Proposals** – The Commission is considering whether to combine the floating NAV and the liquidity fees and gates proposals into a single reform package. If adopted in that form, prime institutional money market funds would be required to transact at a
floating NAV and all non-government money market funds would be able to impose liquidity fees or gates in certain circumstances. The Commission requests public comments on the benefits and drawbacks of a single reform approach.

Enhanced Disclosure Requirements – In addition to requiring certain disclosures relating to the floating NAV and fees and gates proposals, the proposal seeks to improve the transparency of money market fund operations and risks by:

- **Website Disclosure** – Money market funds would be required to disclose on their website, on a daily basis, their levels of daily and weekly liquid assets and market-based NAVs per share.
- **New Material Event Disclosure** – Money market funds would be required to promptly disclose certain events on a new form (Form N-CR). These events would include the imposition or lifting of fees or gates, portfolio security defaults, sponsor support, and – for funds that would continue to maintain a stable share price under either alternative – a fall in the fund’s market based NAV per share below $0.9975.
- **Disclosure of Sponsor Support** – Money market funds would be required to disclose historic instances of sponsor support for money market funds (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. Under the proposal, Form N-MFP would be amended to clarify existing requirements and require reporting of additional information relevant to assessing money market fund risk. In addition, the proposal would eliminate the current 60-day delay on public availability of the information filed on the form and would make it public immediately upon filing.

Improved Private Liquidity Fund Reporting – To better monitor whether substantial assets migrate to liquidity funds in response to money market fund reforms, the proposal would amend Form PF, which private fund advisers use to report information about certain private funds they advise.

The proposed changes would 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 would report on Form N-MFP. A liquidity fund is essentially an unregistered money market fund.

Stronger Diversification Requirements – The proposal includes the following proposed changes to the diversification requirements of money market funds’ portfolios:

- **Aggregation of Affiliates** – Money market funds would be required to aggregate affiliates for purposes of determining whether they are complying with money market funds’ 5 percent concentration limit. Under this limitation, a fund may not invest any more than 5 percent of its assets in any one issuer.
- **Removal of the 25 Percent Basket** – All of a money market fund’s assets would need to meet the concentration limits for guarantors and ‘put’ providers, thereby removing the so-
called 25 percent basket that permitted a single guarantor to guarantee 25 percent of a money market fund’s assets.

- **Asset-Backed Securities** – Money market funds would need to aggregate all of the asset-backed securities vehicles sponsored by the same entity for purposes of the 10 percent guarantor diversification limit. However, this would not be necessary if a money market fund’s board of directors determines the fund is not relying on the sponsor’s strength or structural enhancements of the asset-backed security in determining the quality or liquidity of the asset-backed security.

**Enhanced Stress Testing** – Under the proposal, the stress testing requirements adopted by the Commission in 2010 would be further enhanced. In particular, a money market fund would be required to stress test against the fund’s level of weekly liquid assets falling below 15 percent of total assets. In addition, the Commission is proposing to strengthen how money market funds stress test their portfolios and report the result of their stress tests to their boards of directors.

**What’s Next?**

The public comment period for the proposal will last for 90 days after its publication in the Federal Register.