

A Swing and a Miss! Swing Pricing Strikes Out in SEC's Money Market Fund Reforms

October 14, 2023 | Client Alert

At a meeting on July 12, 2023, the U.S. Securities and Exchange Commission (SEC), in a 3-2 vote, adopted amendments to Rule 2a-7 under the Investment Company Act of 1940 (1940 Act) that impact the operation and management of money market funds.¹ Here is what you need to know.

Key Items Included in Rulemaking Package

- Removal of redemption gates from Rule 2a-7.
- Modified liquidity fee framework:
 - Removal of the tie between weekly liquid assets (WLA) and liquidity fee requirements.
 - Mandatory liquidity fees for institutional prime and institutional tax-exempt money market funds.²
 - Discretionary liquidity fees for nongovernment money market funds.
- Changes to portfolio liquidity requirements:
 - Increase daily liquid asset (DLA) and WLA requirements to 25% and 50%, respectively.
 - Board notification and public SEC filing if a money market fund has less than 25% or 12.5% of total assets invested in WLA or DLA, respectively.
 - Changes to stress testing requirements to require testing of the ability to maintain a sufficient liquidity level under specified hypothetical events.
- Permit stable net asset value (NAV) money market funds to use share cancellation in a negative interest rate event, subject to board determinations and disclosure requirements.
- Amendments to SEC reporting requirements on Forms N-MFP, N-1A, N-CR and PF that will require additional items to be reported to the SEC.
- Clarifications on dollar-weighted average portfolio maturity (WAM) and dollar-weighted average life maturity (WAL) calculations.

¹ Money Market Fund Reforms; Form PF Reporting Requirements for Large Liquidity Fund Advisers; Technical Amendments to Form N-CSR and Form N-1A, Investment Company Act Release No. 34959 (July 12, 2023), available at <https://www.sec.gov/files/rules/final/2023/33-11211.pdf> [hereinafter the Adopting Release].

² For purposes of this client alert, we refer to institutional prime and institutional tax-exempt money market funds as "institutional funds."

Key Items Not Included in the Rulemaking Package

- Mandatory swing pricing.
- Prohibition on share cancellation.
- Requirement for stable NAV money market funds to determine that financial intermediaries have the capacity to transact at prices other than a stable NAV.
- Certain Form N-MFP amendments:
 - Disclosure of the name of each shareholder who owns 5% or more of the money market fund.
 - Lot-level reporting of portfolio holdings and disaggregated information for certain repurchase agreement reporting on Form N-MFP.

This client alert will review the various requirements of the SEC's rulemaking package and related compliance dates and provide practical tips for managers and boards of directors of money market funds to implement and comply with the new money market fund reforms. For information on amendments to SEC forms and related disclosure considerations, please see our separate [client alert](#).

Stradley Ronon is pleased to host a webinar on Sept. 6, 2023, at 12:00 pm (Eastern time) on money market fund reform. We hope that you can join us. Details will follow soon.

Please let our money market fund team know if you have any questions about the rulemaking package or this alert.

Removal of Redemption Gates

As proposed, the SEC adopted amendments to remove redemption gates from Rule 2a-7.³ As a result, money market funds will no longer be subject to the provisions of Rule 2a-7 that had permitted certain types of money market funds to temporarily suspend redemptions if liquidity decreased below specified liquidity thresholds.⁴ Money market funds will retain the ability to rely on a separate rule under the 1940 Act, Rule 22e-3, to impose permanent gates to facilitate an orderly liquidation of a money market fund.⁵

Modified Liquidity Fee Framework

Following significant opposition to the SEC's swing pricing proposal for money market funds, the SEC adopted a modified liquidity fee framework in place of the SEC's proposal to require money market funds to implement swing pricing. Unlike the current liquidity fee framework, a money market fund's ability to impose a liquidity fee will no longer be tied to the fund's level of WLA. Instead, the modified liquidity fee contains two liquidity fee components: (i) a mandatory liquidity fee based on net redemptions and (ii) a discretionary liquidity fee based on a best interest

³ See Section II.A of the Adopting Release.

⁴ Specifically, Rule 2a-7 permits nongovernment money market funds to impose a redemption gate if the fund had invested less than 30% of its total assets in WLA and the fund's board of directors determined that the redemption gate was in the best interests of the fund.

⁵ Rule 22e-3 permits money market funds to suspend redemptions and postpone the payment of proceeds if (i) the money market fund, at the end of a business day, has invested less than 10% of its total assets in WLA or, in the case of a government or retail money market fund, the fund's market-based NAV has deviated from the stable price established by the board of directors or the fund's board of directors determines that such a deviation is likely to occur; (ii) the board has irrevocably approved the money market fund's liquidation and (iii) prior to suspending redemptions, the money market fund has notified the SEC. See 17 CFR 270.22e-3.

finding by the board of directors (or its delegate).⁶ The following summarizes the key aspects of the modified liquidity fee regime.

	Mandatory Liquidity Fee	Discretionary Liquidity Fee
Funds in Scope	Institutional prime and institutional tax-exempt money market funds	Nongovernment money market funds. Government money market funds may opt in to the discretionary liquidity fee framework.
When Fee Applies	A mandatory liquidity fee is charged to redeeming investors when the money market fund has net redemptions above 5% of net assets (or such smaller amount as determined by the board or its delegate).	A discretionary liquidity fee is charged to redeeming investors when the board determines that the fee is in the best interests of the money market fund.
Size of Fee	The size of the fee generally is determined by making a good faith estimate of the spread, other transaction, and market impact costs the fund would incur if the fund were to sell a pro rata amount of each security in its portfolio to satisfy the amount of net redemptions. The final rule contains a de minimis exception if estimated liquidity costs are less than one basis point of the value of the shares redeemed. There is no upper limit on the mandatory liquidity fee.	Rule 2a-7 does not prescribe the manner or amount of the fee calculation. The fee, however, must be in the best interests of the money market fund and cannot exceed 2% of the value of the shares redeemed.

Mandatory Liquidity Fee Framework

Net Redemption Threshold

The final rule requires institutional funds to apply a mandatory liquidity fee when net redemptions for the business day exceed 5% of the fund's NAV based on flow information available within a reasonable period after the last computation of the fund's NAV on that day, or such smaller amount of net redemptions as the board of directors (or its delegate) determines.⁸ If the threshold is crossed, the institutional fund must apply a liquidity fee to all shares that are redeemed at a price computed on that day.

Did you know? The SEC's mandatory liquidity fee framework will impact approximately \$666.5 billion in institutional fund assets.⁷

⁶ Including a majority of the directors who are not "interested persons" as defined in the 1940 Act.

⁷ As of June 2023. This figure includes both public and nonpublic institutional funds, both of which will be subject to mandatory liquidity fees. See Money Market Fund Statistics: Form N-MFP Data, period ending June 2023, SEC Division of Investment Management Analytics Office (July 24, 2023), *available at* <https://www.sec.gov/files/mmf-statistics-062023.pdf>.

⁸ Amended Rule 2a-7(c)(2)(ii).

The mandatory liquidity fee framework requires that institutional funds calculate net redemptions based on actual flow data for the day, as opposed to estimates of flows. To determine whether an institutional fund has crossed the 5% threshold, the final rule requires an institutional fund to use information about its net flows for the day that are available within a reasonable period of time after the last pricing time of that day. In determining when to calculate its net flows, the SEC has stated in the Adopting Release that an institutional fund should consider historical data on when it typically receives flow information and may also consider the period of time needed to calculate and apply fees.⁹ To the extent that an institutional fund receives additional flow information after determining that it crossed the 5% threshold, but before applying a liquidity fee, the SEC has stated that an institutional fund can take the additional flow information into account when determining the amount of the liquidity fee.¹⁰ In addition, to the extent that an institutional fund did not have net redemptions of more than 5% within a reasonable period after the last pricing period but subsequently received additional net redemptions that would cause it to cross the threshold, the SEC has stated in the Adopting Release that the fund should consider imposing a liquidity fee under the discretionary liquidity fee provision of Rule 2a-7.¹¹

Practice Point: When the 5% net redemption threshold is crossed, the mandatory liquidity fee must be applied to all shares redeemed that day, including redemptions that are eligible to receive a NAV computed on that day even if received by the institutional fund after the last pricing period of the day.

Unlike the proposal, the net redemption threshold is based on flows for **all** pricing periods in a given day. An institutional fund with multiple share classes must include net flow activity across all share classes in the aggregate when determining whether the fund has crossed the 5% threshold rather than applying the threshold on a class-by-class basis.¹²

The final rule permits a fund's board (or its delegate) to use a lower net redemption threshold than is required. This is designed to recognize that there may be circumstances in which a smaller threshold would be appropriate to mitigate dilution of fund shareholders, such as when a fund holds a larger amount of less-liquid investments or in times of stress.¹³

Calculation of Mandatory Liquidity Fees

The mandatory liquidity fee framework requires that the fee be based on a good faith estimate, supported by data, of the costs the institutional fund would incur if it sold a pro rata amount of each security in its portfolio (a vertical slice) to satisfy the amount of net redemptions, including (i) spread costs, such that the fund is valuing each security at its bid price, and any other charges, fees and taxes associated with portfolio security sales and (ii) market impacts for each security.¹⁴

Practice Point: There are no exceptions to the liquidity fee requirements for small redemptions. The final rule requires the application of a mandatory liquidity fee regardless of the size of the redemption.

⁹ Adopting Release at 62.

¹⁰ *Id.* at 64.

¹¹ *Id.* at 64-65.

¹² *Id.* at 62-63.

¹³ *Id.* at 55.

¹⁴ See amended Rule 2a-7(c)(2)(iii)(A).

The final rule does not require an institutional fund to impose the mandatory liquidity fee if its estimated liquidity costs are de minimis, which is defined as less than 0.01% of the value of the shares redeemed.¹⁵ The final rule does not impose a cap on the maximum amount that can be charged under the mandatory liquidity fee framework.

With respect to determining market impacts, an institutional fund would first establish a market impact factor for each security, which is a good faith estimate of the percentage change in the value of the security if it were sold, per dollar of the amount of the security that would be sold, if the fund sold a pro rata amount of each security in its portfolio to satisfy the amount of net redemptions, under current market conditions. The institutional fund would then multiply the market impact factor by the dollar amount of the security that would be sold.¹⁶

Practice Point: A money market fund may assume a market impact of zero for its DLA and WLA.

In response to comments on the proposal, if the costs of selling a vertical slice of the portfolio cannot be estimated in good faith and supported by data, then the fund must apply a default liquidity fee of 1% of the value of shares redeemed.¹⁷

The SEC has listed pricing grids as a potential method to establish good faith estimates of market impact costs supported by data. Specifically, an institutional fund could estimate and document in pricing grids the effect of selling different amounts of the security on a security's price for each group of securities in its portfolio with the same or substantially similar characteristics. Under a grid-based approach, an institutional fund would develop separate grids for different market conditions, such as normal market conditions or periods with credit stress, liquidity stress or interest rate stress (or a combination of such stresses), and the grids would assess the market impact of selling different amounts of a security.¹⁸

The final rule permits an institutional fund to make a good faith estimate of costs for each type of security with the same or substantially similar characteristics and apply those good faith estimates to all securities of that type in the fund's portfolio rather than analyze each security separately.¹⁹ The SEC has stated in the Adopting Release that an institutional fund could determine that the liquidity, trading, and pricing characteristics of a subset of securities justify the application of the same costs and market impact factor to all securities of that type within its portfolio. Further examples of the kinds of criteria that an institutional fund might consider when determining how to group securities could include issuance size, creditworthiness, number of other investors in the same issuance, maturity, industry and geographic region.²⁰

¹⁵ See amended Rule 2a-7(c)(2)(iii)(D).

¹⁶ See amended Rule 2a-7(c)(2)(iii)(A)(2).

¹⁷ This could occur, for example, if a fund encountered unforeseen market conditions not contemplated in advance and the fund was not able to otherwise make a good faith estimate of its liquidity costs. Adopting Release at 68.

¹⁸ *Id.* at 73-74. If an institutional fund uses grids to implement its market impact calculations, it generally should review the grids periodically and update them to account for recent market data.

¹⁹ Amended Rule 2a-7(c)(2)(iii)(B).

²⁰ Adopting Release at 72-73.

Special Considerations for Multiple NAV Strike Money Market Funds

The modified liquidity fee regime will necessitate an institutional fund that offers multiple NAV strikes to develop a method for applying the fee to shares redeemed in an earlier pricing period on that day. The SEC has provided the following examples of methods a fund may employ:

- Applying the liquidity fee charge to the remaining balance in an investor's account if the investor did not redeem the full amount of their shares in the money market fund.
- Holding back a portion of the redemption proceeds until the end of the day when the liquidity fee determination is made.
- Developing a mechanism for taking back a portion of redemption proceeds that the investor has already received.²¹

Money market funds and intermediaries may also develop other approaches to address this issue.²²

Discretionary Liquidity Fee Framework

In addition to the mandatory liquidity fee framework discussed above, the final rule also contains a discretionary liquidity fee framework if the board of directors²³ (or its delegate) determines that a liquidity fee is in the best interest of the fund.²⁴ This framework applies to nongovernment money market funds.²⁵

Similar to the current liquidity fee framework, a government money market fund may opt in. Once imposed, the discretionary liquidity fee must be applied to all shares redeemed and remain in effect until the money market fund's board of directors (or its delegate) determines that imposing such liquidity fee is no longer in the best interest of the fund.

Practice Point: The threshold for applying a mandatory or discretionary liquidity fee is not tied to weekly liquid levels and is not limited to stressed market conditions.

Unlike the mandatory liquidity fee framework, Rule 2a-7 does not prescribe the method under which a discretionary liquidity fee is calculated, but Rule 2a-7 does provide an upper limit for a discretionary liquidity fee of 2% of the value of shares redeemed.²⁶

Unlike the current liquidity fee framework, the discretionary liquidity fee framework is not tied to a money market fund's liquidity levels. This means that a discretionary liquidity fee can be applied regardless of a fund's liquidity levels, provided the fund's board of directors (or its delegate) determines it is in the best interest of the fund to impose a liquidity fee.²⁷ In a further change from the current liquidity fee framework, amended Rule 2a-7 permits a board to

²¹ *Id.* at 60.

²² In considering different approaches with respect to implementing liquidity fees for multiple NAV strike money market funds, funds should also consider the tax consequences of such approaches.

²³ Including a majority of the directors who are not "interested persons" as defined in the 1940 Act.

²⁴ Amended Rule 2a-7(c)(2)(i).

²⁵ In comparison to the mandatory liquidity fee framework, the discretionary liquidity fee framework also includes retail money market funds.

²⁶ Amended Rule 2a-7(c)(2)(i).

²⁷ Money market funds may wish to revisit the guidance in the SEC's 2014 release adopting amendments to Rule 2a-7 regarding factors a board may consider in determining whether it is in the best interest of the fund to impose a liquidity fee and in considering the amount of such fee. Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 31166, 91-92 (July 23, 2014), *available at* <https://www.sec.gov/files/rules/final/2014/33-9616.pdf>.

delegate its duties under the liquidity fee provisions of Rule 2a-7, subject to written guidelines and board oversight.²⁸

Recordkeeping Rules

Under amended recordkeeping rules, a money market fund must retain records that document how it determines the amount of any liquidity fee.²⁹ This includes both mandatory and discretionary liquidity fees.

Disclosure and SEC Reporting

Information on the imposition of liquidity fees will be required to be reported in an institutional fund's registration statement and on Form N-MFP. For a discussion of these disclosure and reporting requirements, please see our separate [client alert](#).

The Role of the Board and Liquidity Fees

The SEC in the Adopting Release describes the board as responsible for administering the liquidity fee requirements.³⁰ In a change from the current liquidity fee framework, amended Rule 2a-7 permits a board to delegate responsibilities related to liquidity fees to the fund's investment adviser or officers, subject to written guidelines established and periodically reviewed by the board and subject to board oversight. Specifically, the board is required to establish and periodically review written guidelines (including guidelines for determining the application and size of liquidity fees) and procedures under which the delegate makes determinations required to be made by the board. Further, the board is required to take any measures reasonably necessary (through periodic review of the delegate's liquidity fee determinations) to ensure that the guidelines and procedures are being followed.³¹

The SEC has stated in the Adopting Release that the written guidelines established by the board generally should specify the manner in which the delegate is to act with respect to any discretionary aspect of the liquidity fee mechanism.³² This includes, for example, whether the fund will apply a fee to a shareholder based on the shareholder's gross or net redemption activity for the relevant day and, for institutional funds, the fund's approach to determining the reasonable period after the last pricing period of the day when the delegate will measure the fund's flows for purposes of the 5% net redemption threshold.

Amended Rule 2a-7 requires the periodic review of the delegate's liquidity fee determinations but otherwise does not mandate any specific board reporting with respect to liquidity fees. Boards may wish to consider the types of reporting that may be useful to assist with their oversight responsibilities with respect to liquidity fees.

²⁸ See amended Rule 2a-7(j).

²⁹ Amended Rule 31a-2(a)(2). For example, if an institutional fund establishes good faith estimates of its liquidity costs by using pricing grids or otherwise, it must preserve records supporting each fee computation. If the institutional fund applies a 1% default liquidity fee, the fund must preserve records supporting its determination that it cannot establish a good faith estimate of its liquidity costs. If an institutional fund determines that its liquidity costs are less than 0.01% of the value of the shares redeemed and therefore the fund is not required to apply a liquidity fee under the rule, the fund must preserve records supporting how it determined that the costs would be less than 0.01%. See Adopting Release at 79.

³⁰ Adopting Release at 43, 45.

³¹ Amended Rule 2a-7(j).

³² Adopting Release at 67, 86.

What Does This Mean for the SEC's Swing Pricing Proposal for Other Open-End Funds?

While the fate of the SEC's swing pricing proposal for other open-end funds remains to be seen, the SEC's position that a "mandatory liquidity fee will reduce operational burdens associated with swing pricing while still achieving many of the benefits [the SEC was] seeking with swing pricing by allocating liquidity costs to redeeming investors in stressed periods"³³ could potentially indicate a shift in the SEC's overall views toward swing pricing.

Changes to Portfolio Liquidity Requirements

Increases to DLA and WLA Requirements

The SEC adopted, as proposed, increases to the DLA and WLA requirements in Rule 2a-7, detailed below.

Increased Liquidity Requirements		
	Current Requirement*	New Requirement*
Minimum DLA (except tax-exempt money market funds)	10%	25%
Minimum WLA	30%	50%
Maximum illiquid securities	5%	5%

* Tested at acquisition.

In a change from the current regulatory framework under Rule 2a-7, a money market fund's ability to impose a liquidity fee is no longer tied to a fund's level of WLA. Consistent with current Rule 2a-7, tax-exempt money market funds will remain exempt from the DLA requirement. Further, compliance with the liquidity requirements will remain tested at acquisition.³⁴ Additionally, the definitions for DLA and WLA remain unchanged.

Several commenters on the SEC's proposal suggested that raising minimum liquidity requirements by such a degree could reduce the spread between prime and government money market funds, which could lead to decreased demand for prime funds. The SEC, however, has rejected the notion that the increased liquidity requirements will have a significantly negative impact on the yield of prime money market funds or lead to less demand for such funds.³⁵

Board Notification and SEC Filing Upon Certain Decreases in DLA and WLA

Amendments to Rule 2a-7 and Form N-CR require a money market fund to notify its board of directors and file on Form N-CR with the SEC if the fund's liquidity falls to less than half of either the required DLA or WLA requirement – i.e., less than 12.5% of its total assets in DLA or less than 25% of its total assets in WLA (a "liquidity threshold event").³⁶ Specifically, a money market fund will be required to notify the board of directors and file on Form N-CR within one business day of the liquidity threshold event. Within four business days of the liquidity threshold event, a money market fund will be required to provide the board with, and file an amended Form N-CR

³³ Adopting Release at 27.

³⁴ This means that decreases in liquidity due to redemptions do not constitute a violation of the applicable DLA or WLA requirements. Rather, a money market fund cannot acquire any asset other than a DLA or WLA (as applicable) until the fund is back above the respective DLA or WLA requirement.

³⁵ Adopting Release at 102.

³⁶ Amended Rule 2a-7(f)(4). Amended Form N-CR Part E.

that contains, a summary of the facts and circumstances causing the liquidity threshold event. Form N-CR is made public immediately upon filing.

The SEC believes that the board notification requirement will “provide the board with timely information in a context that would better facilitate the board’s understanding and monitoring of significant declines in the fund’s liquidity levels.”³⁷ Rule 2a-7 does not prescribe any specific action to be taken by a board upon such notification. A board, however, may wish to consider available liquidity risk management tools, stress testing results, and information from management related to the potential for future decreases in liquidity or plans to increase the fund’s liquidity levels.

For additional information on Form N-CR reporting requirements, please see our separate [client alert](#).

Amendments to Liquidity Metrics in Stress Testing

The SEC has also adopted, as proposed, amendments to the liquidity metrics for stress testing that will require money market funds to test their ability to maintain sufficient minimum liquidity under various hypothetical events.³⁸

This requirement will be in place of the current requirement for a money market fund to test its ability to have invested at least 10% of its total net assets in WLA. The SEC stated that money market funds should consider “the type of money market fund, investor concentration, investor composition and historical distribution of redemption activity under stress” when determining sufficient minimum liquidity for a fund.³⁹ The SEC has not adopted changes to other stress testing requirements, including the hypothetical events required to be tested under Rule 2a-7.

Negative Interest Rates

In a change from the proposal, the SEC adopted amendments to Rule 2a-7 to permit the use of share cancellation in a negative interest rate environment, provided certain conditions are met. Share cancellation is the process of reducing the number of shares outstanding to seek to maintain a stable NAV per share or stable price per share. Specifically, under amended Rule 2a-7, a government or retail money market fund may not use share cancellation unless (i) the fund has negative gross yield as a result of negative interest rates (a “negative interest rate event”), (ii) the board of directors determines that reducing the number of the fund’s shares outstanding is in the best interests of the fund and its shareholders and (iii) timely, concise and plain-English disclosure is provided to investors about the fund’s share cancellation practices and their effects on investors.⁴⁰

Practice Point: Under amended Rule 2a-7, a money market fund will be required to:

- Determine the minimum level of liquidity it seeks to maintain during stress periods.
- Identify that liquidity level in its written stress testing procedures.
- Periodically test its ability to maintain such liquidity.
- Provide its board with a report on the results of the testing.

³⁷ Adopting Release at 107.

³⁸ See amended Rule 2a-7(g)(8)(i) and (g)(8)(ii)(A).

³⁹ Adopting Release at 209.

⁴⁰ Amended Rule 2a-7(c)(3).

Accordingly, under amended Rule 2a-7, a stable NAV money market fund will be permitted to either (i) convert to a floating NAV or (ii) engage in share cancellation in a negative interest rate event.⁴¹ If a stable NAV money market fund converts to a floating NAV, the fund's losses will be reflected through a declining share price. If a stable NAV money market fund uses a share cancellation mechanism, the fund will maintain a stable share price, despite losing value, by reducing the number of its outstanding shares. Investors in such a money market fund would observe a stable share price but a declining number of shares for their investment.

The Role of the Board and Share Cancellation

Under amended Rule 2a-7, a stable NAV money market fund may only use share cancellation if the board of directors determines that doing so is in the best interest of the fund and its shareholders. This is a nondelegable duty under Rule 2a-7, meaning that the board of directors is not permitted to delegate its responsibilities to make determinations related to share cancellation to the money market fund's investment adviser or its officers.⁴²

Among other things, in determining whether cancelling shares to maintain a stable NAV is in the best interests of the fund and its shareholders, the SEC has stated that a board generally should consider the following:

- The capabilities of the fund's service providers and intermediaries to support the equitable application of a reverse distribution mechanism across the fund's shareholders, including considerations of whether the operational and recordkeeping systems of the service providers and intermediaries are able to process and apply a pro rata reduction of shares in shareholder accounts on a daily basis.
- Any state law limitations on share cancellation.⁴³

Additionally, in determining the best interests of the money market fund and its shareholders, the board will also need to consider applicable tax rules. This includes the tax implications of share cancellation for the money market fund itself as well as for the money market fund's shareholders, taking into account the possibility that no new tax guidance or legislation may be forthcoming.⁴⁴

Disclosure and SEC Reporting

Should a negative interest rate event occur, amended Rule 2a-7 provides that a fund must provide timely, concise and plain-English disclosure about the fund's share cancellation practices and their effects on investors both before and during the negative interest rate event, including (i) advance notification to investors in the money market fund's prospectus that the fund plans to use share cancellation in a negative interest rate event and potential effects on investors and (ii) when the money market fund is cancelling shares, information in each account statement or in separate writing accompanying each account statement identifying that such

⁴¹ Adopting Release at 116.

⁴² See amended Rule 2a-7(j).

⁴³ Adopting Release at 117. The SEC has further stated that the board also generally should review its determination that share cancellation is in the best interests of the money market fund and its shareholders if circumstances change, including if a negative interest rate event appears to be reasonably likely to occur in the near future. *Id.* at 119.

⁴⁴ *Id.* at 118

practice is in use and explaining its effect on investors. For additional information on disclosure obligations in a negative interest rate event, please see our separate [client alert](#).

Conversion to Floating NAV Money Market Fund in a Negative Interest Rate Event

Amended Rule 2a-7 permits a stable NAV money market fund to either convert to a floating NAV or to engage in share cancellation in a negative interest rate event. While amended Rule 2a-7 does not directly address disclosure requirements should a stable NAV money market fund convert to a floating NAV money market fund, the SEC has stated in the Adopting Release that a stable NAV money market fund that plans to convert to a floating NAV if it has negative gross yield due to negative interest rates generally should consider similar prospectus, shareholder report and account statement disclosures, as applicable, as required for share cancellation given investors' lack of experience with negative interest rates and the potential expectation that the fund will continue to maintain a stable NAV.⁴⁵

In a change from the proposal, the SEC did not adopt a requirement that stable NAV money market funds determine that each financial intermediary in the fund's distribution network has the capacity to redeem and sell the fund's shares at nonstable prices or, if this determination cannot be made, prohibit the relevant intermediary from purchasing the fund's shares in nominee name. The SEC did, however, provide guidance to address how funds and intermediaries generally should prepare for the possibility of a stable NAV fund's conversion to a floating NAV fund, noting the importance of a stable NAV money market fund to understand the capabilities of their distribution network in the event the fund breaks the buck. Specifically, the SEC has stated that a stable NAV money market fund "generally should have a proactive plan or playbook in place for such an event that takes into account how different intermediaries in the fund's distribution network would address a fund's use of a floating NAV."⁴⁶ This could include, for example, whether the intermediary has an automated process for processing transactions at a floating NAV or would need to manually process such transactions, as well as the likelihood that an intermediary using a manual approach would move investors to an alternative investment to mitigate the burdens of its manual process.

Calculation of WAM and WAL

The SEC adopted, as proposed, amendments to specify the calculations of WAM and WAL such that money market funds will be required to calculate WAM and WAL based on the percentage of each security's market value in the portfolio (versus on the amortized cost of each portfolio security).⁴⁷ The SEC did not adopt any changes to the substantive WAM and WAL calendar-day limitations or the maturity shortening provisions of Rule 2a-7.

⁴⁵ *Id.* at 123. For more information on disclosure obligations, please see our separate [client alert](#).

⁴⁶ Adopting Release at 125.

⁴⁷ Amended Rule 2a-7(d)(1).

Compliance Timeline



Practice Pointers and Considerations for Implementation

In connection with the SEC's money market fund reforms, funds, advisers and boards have various steps to consider in implementing the reforms. These considerations include:

Liquidity Fees

- Coordinating with financial intermediaries and other service providers in order to implement the SEC's modified liquidity fee framework. This may include:
 - Updating systems to apply liquidity fees to redemptions on the day the net redemption threshold is crossed.
 - Updating arrangements with intermediaries to obtain the gross (versus net) amount of redemptions for a given day in a timely manner.
 - Coordinating with intermediaries to develop or modify procedures and systems for intermediaries to apply fees to individual investors and submit liquidity fee proceeds to the money market fund, including coordination to impose fees on an investor-by-investor basis (which may be more difficult with respect to omnibus accounts).
- Deciding the approach to determining the reasonable period after the last pricing period of the day to measure the fund's flows for purposes of the 5% net redemption threshold.
- Determining whether the fund will apply a liquidity fee to a shareholder based on gross or net redemption activity for the day.
- For funds with multiple NAV strike times, determining a method to apply liquidity fees that accommodate multiple NAV strikes.
- Updating registration statement disclosure to reflect the new liquidity fee regime (and removal of redemption gates).
- Developing guidelines pursuant to which an investment adviser makes determinations delegated by the board of directors.

- Updating board reporting to accommodate periodic review of liquidity fee determinations.
- Updating recordkeeping practices to accommodate new liquidity fee recordkeeping requirements.

Stress Testing

- Considering and determining the minimum level of liquidity the fund seeks to maintain during stress periods for purposes of stress testing.
- Updating compliance policies and procedures to reflect the new minimum level of liquidity being tested.
- Updating stress testing reports to the board to reflect the new minimum level of liquidity being tested.

Negative Interest Rates

- For stable NAV money market funds, preparing a proactive plan or playbook for a break-the-buck event that takes into account how different intermediaries in the fund's distribution network would address the fund's use of a floating NAV.
- For stable-value money market funds that may seek to use share cancellation in a negative interest rate event, considering capabilities of service providers to support the application of share cancellation, reviewing state law and charter document limitations, if any, and considering tax implications.
- Updating registration statement disclosure as needed.

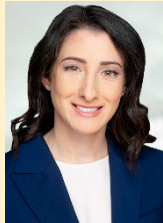
Other

- Updating compliance policies and procedures.
- Updating registration statement disclosure (for example, as applicable, disclosure discussing minimum levels of WLA and DLA, modified liquidity fee framework, share cancellation).
- Updating board reporting (see sections on stress testing and liquidity fees).
- Updating systems to accommodate revised SEC Form N-MFP reporting requirements (including ensuring information required to be reported is being tracked and is readily available for SEC reporting).⁴⁸

⁴⁸ For a further discussion on disclosure requirements, please see our separate [client alert](#).

Please let our money market fund team know if you have any questions about the rulemaking package or this client alert.

For more information, contact:



Jamie M. Gershkow

Partner

212.404.0654

jgershkov@stradley.com



Alison M. Fuller

Partner

202.419.8412

afuller@stradley.com



Geena Marzouca

Associate

202.507.6408

gmarzouca@stradley.com

The authors would like to thank **Jocelyn Near** for her assistance with this client alert.