FS Regulatory Brief

Money market funds: SEC proposes new rules

June 2013

The SEC voted unanimously to propose new rules intended to reform money market funds. The SEC proposed two alternatives, in addition to additional disclosures, regulatory reporting, diversification requirements and stress testing. SEC Commissioners indicated that the proposal is designed to address liquidity concerns identified in the wake of the 2008 financial crisis and was informed by the December 2012 study conducted by the SEC's Division of Risk, Strategy, and Financial Innovation. Several Commissioners also noted that the SEC was the appropriate oversight body for money market funds, in light of the FSOC's focus on this issue.

The SEC is requesting comments on each proposal separately, as well as whether both proposals should be enacted together. The comment period is 90 days.

Floating NAV for prime institutional funds

The first alternative would require prime institutional funds to utilize a floating net asset value ("NAV") when valuing their money market funds. Chairman White noted that prime institutional funds hold $3 trillion in assets. Currently, these funds transact at a stable $1.00 share price and "penny round" their share price to the nearest one percent. The floating NAV proposal would instead require institutional funds to stop using amortized costs to value their portfolio and round their share price to the nearest 1/100th of a percent (the fourth decimal place). The SEC indicated that the floating NAV is intended to quell potential redemption runs by eliminating the current incentive for investors to respond to adverse market conditions by redeeming early at the fixed $1 share.

Retail and government funds would be exempt from this alternative and could continue the penny rounding method of valuation. Retail funds would be broadly defined as those funds limiting each shareholder's redemptions to no more than $1 million per business day. SEC staff indicated that the $1 million threshold was designed to be high enough to allow individuals to utilize the funds in a manner consistent with current practice, while low enough to prevent a run on such funds and make them unattractive to institutional investors. Government funds are those holding at least 80% of their assets in cash, government securities, or repurchase agreements collateralized with government securities.

Liquidity fees and redemption gates

The second alternative would allow funds to maintain a stable $1 share price, but would provide them the ability to impose liquidity fees and redemption gates in times of market stress. Funds whose "weekly liquid assets" (e.g., cash, US Treasury securities, certain other government securities with remaining maturities of 60 days or less, and securities that convert to cash within one week) fall under 15% of their total assets (the required amount is 30%) would be required to impose a 2% liquidity fee on all redemptions. However, a fund's board of directors could determine that such a fee is not in the best interest of its investors and either impose a lower fee or no fee at all.

In addition to the liquidity fee, a board of directors could impose a temporary suspension of redemptions (a "gate") on a fund once below the 15% threshold. Gates would have to be lifted after 30 days (although they could be lifted earlier), and may not be imposed for more than 30 days over any 90 day period. The redemption fee and gates would not be allowed once the weekly liquid assets rose above 30% of total assets.

pwc

Additional proposals

The SEC also proposed new requirements relating to disclosure, stress testing, reporting and diversification for all money market funds.

Disclosure

- Money market funds would have to include new disclosures in the prospectus about the investment and liquidity risks associated with money market funds. Funds would also be required to disclose information about shadow NAVs on their websites.
- A new Form N-CR would be used by money market funds to report material events, such as weekly liquidity below the minimum 15% threshold, or sponsor support. Funds would also have to disclose the board's analysis and factors contributing to their decision to impose a fee or gate. Form N-CR would be publicly available.

Stress testing

- 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% of total assets. New rules would change how stress test results are reported to a fund's board.

Reporting

- Form PF: A "large liquidity fund adviser" (a liquidity fund adviser managing at least $1 billion in combined money market fund and liquidity fund assets) would be required to report substantially the same portfolio information on Form PF as registered money market funds report on Form N-MFP.
- Form N-MFP would be immediately publicly available.

Diversification

- Certain affiliated entities would be treated as a single issuer for purposes of the diversification requirements; asset backed securities sponsors would be treated as guarantors for diversification purposes (unless the board determines that the fund is not relying on the sponsor); and the 25% basket would be removed so that funds could not rely on a single issuer to "guarantee" a quarter of the fund's portfolio.

We are further analyzing the proposed rules and will provide in the near future a more detailed summary and an analysis of the rules' impact.

Additional information

For additional information about PwC's Financial Services Regulatory Practice and how we can help you, please contact:

Dan Ryan
Financial Services Regulatory Practice Chairman
646 471 8488
daniel.ryan@us.pwc.com

Alison Gilmore
646 471 0588
alison.gilmore@us.pwc.com

Contributors: Lori Richards and David Harpest.

www.pwcregulatory.com

To learn more about financial services regulation from your iPad or iPhone, click here to download PwC's new Regulatory Navigator App from the Apple App Store.

Follow us on Twitter @PwC_US_FinSrvcs