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What You Need to Know About Money Market Fund Reform - Ratings

By Joan Ohlbaum Swirsky and Jamie M. Gershkow

SEC Reproposes Removal of Credit Ratings From Rule 2a-7; Proposes to Tighten Issuer Diversification Requirements and to Provide Relief From Immediate Delivery of Confirmations for Floating Net Asset Value Money Market Funds

On July 23, the U.S. Securities and Exchange Commission (SEC) reproposed amendments (the Reproposal) removing the requirement that a money market fund (a fund) limit its investments to those rated within the top two categories by rating agencies (or to unrated securities of comparable quality).¹ In place of that requirement, the fund's board of directors or its delegate (such as the investment adviser) must determine whether each security presents minimal credit risks. In making that determination, the board of directors or its delegate must find that the security's issuer has an exceptionally strong capacity to meet its short-term obligations. While the minimal credit risks determination is currently required by Rule 2a-7 (the Rule) under the Investment Company Act of 1940, as amended (the 1940 Act), the only basis for that determination is "factors pertaining to credit quality." The current limit on securities rated in the second-tier short-term rating category to three percent of the portfolio (1/2 percent in any one second-tier issuer) would be eliminated, as there would be no distinction between first-tier and second-tier securities under the Rule.

The SEC also proposes to tighten issuer diversification requirements and to provide exemptive relief from the requirement that a broker deliver a confirmation immediately following each transaction for floating net asset value funds.

The Reproposal is part of the SEC's process to implement Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which became law in July 2010. Section 939A directs the SEC, "to the extent applicable, [to] review any regulation that requires an assessment of credit-worthiness," to "modify any such regulations identified by the review" in order to remove references to or requirements for reliance on ratings, and to substitute a standard of creditworthiness as the SEC determines to be appropriate. This directive addresses the concern that investors and regulators may have relied too heavily on rating agency ratings rather than on independent credit analysis – particularly in light of perceived errors by rating agencies during the financial crisis of 2008, when rating agencies rapidly downgraded highly rated structured investment vehicle securities.

The release setting forth the Reproposal (the Release) provides guidance regarding some of the factors that a fund may consider in its minimal credit risk determinations, including specific guidance relating to municipal securities, conduit securities, asset-backed securities, other structured securities and repurchase agreements. *See attachment for a list of these factors.*

The Reproposal also revises certain requirements to list ratings on portfolio securities in Form N-MFP, which funds file monthly with the SEC to report portfolio holdings and other information.

Commissioner Expresses Misgivings

The SEC considered the role of ratings in the Rule on four occasions in the past, most recently in 2011 (the 2011 Proposal), and each time many industry commentators opposed eliminating the ratings standard from the Rule.² Indeed, at the open meeting at which the SEC approved the 2011 Proposal, SEC Commissioner Luis A. Aguilar expressed misgivings about the removal of credit ratings and said that Congress should amend the Dodd-Frank Act to eliminate the requirement to remove ratings, and instead require that ratings-based determinations be confirmed by additional risk analysis. He pointed out, as many industry commentators have noted, that the Rule already includes a requirement that each security present “minimal credit risks,” as determined by the fund’s board,³ in addition to the credit rating requirement. Accordingly, the rating is a quality floor rather than a safe harbor, and removing the floor “runs counter to the entire philosophy of Rule 2a-7.” Further, Commissioner Aguilar stated that a subjective standard to replace ratings would be difficult to oversee. Commissioner Aguilar reiterated his doubts when discussing the Reproposal, noting that the amendments could encourage funds to invest in riskier portfolios.

Possible Effects of the Reproposal to Remove References to Ratings

The SEC points out that, in many respects, the practical effects of the Reproposal to remove ratings from the Rule may not be significant. On the other hand, certain aspects of portfolio management may change. Some limited effects and some possible changes are summarized below.

Ratings still important? The Reproposal would eliminate the requirement that a fund determine the credit ratings of portfolio securities (or determine that the quality of an unrated security is comparable to the quality of a security with the requisite ratings). However, boards, advisers and shareholders may continue to consider ratings an important component of credit quality assessment. The SEC says, “we believe that the majority of funds would continue to refer to credit ratings in making minimal credit risk determinations.” In addition, although the Rule will not reference ratings, funds may, in effect, limit themselves to securities rated within the top two short-term tiers, as the SEC says it does not believe that securities rated in the third-highest category for short-term ratings (or comparable unrated securities) would satisfy the repropoed “exceptionally strong capacity” standard in the amended Rule. The SEC says that the new standard “is designed to preserve the current degree of risk limitation in Rule 2a-7.”

Possible change: Due diligence regarding ratings methodologies. The SEC states that in assessing credit risk, a



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fund adviser could take into account credit quality determinations prepared by outside sources, including rating agencies, that the adviser considers are reliable. If a fund continues to consider ratings, the adviser may need to engage in some due diligence regarding the ratings that some advisers may not have undertaken in the past. Specifically, the SEC states that “[i]n considering such sources [as ratings], an adviser should understand the particular [rating agency]’s methodology for determining the rating at issue and make an independent judgment of credit risks, and it should consider any outside source’s record with respect to evaluating the types of securities in which the fund invests.”

Reassessment on downgrade replaced by “ongoing” monitoring, but current practices may continue? The Reproposal also would revise the provision of the Rule that requires reassessment upon downgrade of a security, by substituting a more general requirement for ongoing review of minimal credit risk. This new requirement is broader than the existing requirement to monitor for a specific event – a downgrade. But the SEC states that it does not believe the changed provision will significantly change current portfolio monitoring practices. The SEC states that “[a]lthough Rule 2a-7 does not explicitly require ongoing monitoring of whether a security presents minimal credit risks, as a practical matter, we believe most fund advisers currently engage in similar types of ongoing monitoring” for several reasons. Specifically, advisers may perform ongoing credit monitoring already because:

- Funds regularly roll over securities, which triggers the obligation to make a new minimal credit risk determination.
- The Rule requires funds to reassess whether a security presents minimal credit risks upon the occurrence of certain events.
- Events such as downgrades can decrease the shadow price of a security.
- Rated funds may need to monitor downgrades to maintain their own ratings.

- Shareholders may be more likely to redeem if credit quality of a holding declines.

The SEC says that “as a practical matter, [an adviser’s obligation to monitor risks to which a fund is exposed would] require the adviser to monitor for downgrades by relevant credit rating agencies.” “Relevant” rating agencies are those agencies whose downgrades would likely affect the value of a portfolio security.

Board still involved in certain downgrades? The Reproposal also eliminates the requirement to inform the board regarding ratings on portfolio holdings below second tier. The SEC points out that “one consequence of our proposal would be that a fund adviser could decide to keep a portfolio security that has been downgraded from second tier status without involving the fund’s board in that decision.” However, this change may not have a significant impact on fund practices. The SEC says, “[a]s part of its oversight of the adviser’s investment decisions, however, we would expect that a fund board generally should establish procedures for the adviser to notify the board in such circumstances.”

Stress testing similar? The Reproposal replaces the requirement to stress test for a downgrade or default of portfolio holdings with a requirement to stress test for an event indicating or evidencing credit deterioration of particular portfolio security positions. But the amendment states that a downgrade or default is an example of the type of event that a fund may test for. Accordingly, some funds that stress test for downgrades may continue to do so.

Form N-MFP reporting may be the same for some funds. In 2011, the SEC had proposed to remove from Form N-MFP questions that asked the ratings of portfolio holdings. The Reproposal abandons that approach and instead revises the questions to require disclosure of only those ratings assigned by any rating agency to which the fund or its adviser subscribes and of any other rating that the adviser considered in making its minimal credit risk determination. Accordingly, for some funds the ratings information in Form N-MFP may not be significantly reduced.

Ratings underlying Conditional Demand Features – existing practices may continue? The amendments eliminate the rating requirement for securities that provide a particular type of “put” right, known as a “Conditional Demand Feature.” The requirement that such securities be rated in one of the top two ratings tiers is replaced by a more subjective quality standard. Although the rating standard has been removed, the SEC states that it does not believe that securities rated in the third-highest category for long-term ratings (or comparable unrated securities) would satisfy the proposed subjective standard.

Minimal credit risk factors – advisers may wish to determine whether any changes are necessary. The Reproposal includes a

list of some of the factors the adviser may consider in its minimal credit risk determinations, further detailed below in the link titled “Some Factors Which Might Be Included in a Minimal Credit Risk Determinations.” Advisers may want to consider whether their credit procedures cover the appropriate factors on this list.

Actions to Comply

No new nondelegable board duties, though procedures and board reports may change. Fund boards typically delegate the day-to-day responsibility for credit quality determinations under the Rule to the investment adviser. The Reproposal does not impose any new duties on fund boards that may not be delegated to the investment adviser.

If the Reproposal is adopted, several actions will be necessary to comply:

- Advisers will need to consider whether they will excise ratings from their credit analysis or continue to consider ratings as an independent third-party viewpoint that may bring to bear expertise not otherwise readily available to each adviser.
- An adviser should take steps to understand the rating agencies’ methodology if the adviser takes ratings into account.
- Funds may need to update their amortized cost and stress-testing procedures, compliance policies and systems, disclosure, and board reports. Among other things,
 - Funds should ensure they have written policies to keep written records of their minimal credit determination that includes the factors considered and an analysis of such factors.
 - Funds must ensure they have written procedures requiring the fund adviser to undertake ongoing review of the credit quality of each portfolio security to determine that the security continues to present minimal credit risks.
 - Funds may establish procedures for the adviser to notify the board should the adviser decide to keep a portfolio security that has been downgraded from second-tier status.
 - Advisers may wish to consider whether it is necessary for them to perform additional credit analysis to satisfy the new subjective credit quality standard based on ability to meet short-term financial obligations.
- Funds will need to reconsider their reporting of ratings on portfolio securities on Form N-MFP.

To assist you in understanding the proposed changes, we have prepared a marked copy of Rule 2a-7 as it would appear if the proposals are adopted. *See attached marked copy.*

Comment Due Date

Comments on the Reproposal and Diversification Proposal are due by October 14, 2014.

Board Designation of Rating Agencies Put to Rest

Amendments to the Rule that became effective during 2010 included a provision requiring fund boards to designate at least four rating agencies as having ratings that are sufficiently reliable as the basis for certain credit quality determinations under the Rule. Boards were to have made this designation and disclosed it in the fund's statement of additional information by December 31, 2010. But the SEC staff has permitted funds to delay implementing this requirement, pending the SEC's implementation of the Dodd-Frank Act's directive to eliminate reference to ratings from rules.⁴ If the Reproposal is adopted, the requirement that boards designate rating agencies will be eliminated from the Rule and will not become effective. Some boards might welcome that result, as it would free them of the task of designating rating agencies as "reliable." If the Reproposal is not adopted, the SEC staff's suspension of implementation of the designation requirement presumably will remain in effect until the SEC implements Section 939A of the Dodd-Frank Act with respect to Rule 2a-7.

SEC Proposes Amendments to the Issuer Diversification Requirement of the Rule

The July 2014 Money Market Fund Reform included changes relating to the Rule's diversification provisions,⁵ including requiring that a fund treat certain entities that are affiliated with each other as single issuers when applying the five percent issuer diversification provision of the Rule and treat sponsors of asset-backed securities as guarantors subject to the 10 percent diversification provisions of the Rule. In the same release as the Reproposal, the SEC proposed a further tightening of the Rule's diversification testing.

Currently under the Rule, there are two separate diversification tests – one that limits a fund's exposure to any one issuer of portfolio securities, and another that limits a fund's exposure to any one provider of credit support on portfolio securities (such as a guarantor). The issuer diversification test generally limits exposure to any one issuer to five percent of the portfolio and exposure to any one guarantor to 10 percent of the portfolio. The rule does not require the first diversification test – the issuer diversification test – to be applied to a security that has a guarantee by a noncontrolled person of the issuer. Such a security is tested only under the second test – the guarantee test. The reason for this exception from testing of the fund's exposure to the issuer is that the fund may be relying only on the credit quality of the guarantor, rather than the credit quality of the issuer, for a security with a guarantee. If so, exposure to the issuer is less important to risk in the fund. However, the

SEC is concerned that this exception may allow a fund to have a portfolio highly concentrated in one issuer.

Accordingly, the proposals would remove the exception to the five percent issuer diversification provision with respect to issuers of securities that are subject to a guarantee by a noncontrolled person (the Diversification Proposal). Accordingly, under the Diversification Proposal, each fund that invests in securities subject to a guarantee would have to comply with both the 10 percent diversification requirement for the guarantor and the five percent diversification requirement for the issuer (the issuer test would apply whether or not the guarantor is a noncontrolled person).

If the Diversification Proposal is adopted:

Advisers should review their compliance programs and portfolio management systems to ensure their programs and systems adequately reflect the new diversification requirements.

Boards will need to adopt revised amortized cost procedures to reflect the new requirements.

SEC Files Notice of Proposed Exemptive Order Under Rule 10b-10

Rule 10b-10(b) permits broker-dealers to provide transaction information (confirmations) for transactions in stable net asset value money market shares on a monthly basis. On July 23, the SEC also filed a Notice of Proposed Exemptive Order (the Notice) that would permit broker-dealers to continue to rely on the current exception under Rule 10b-10(b) with respect to transactions in floating net asset value fund shares instead of sending immediate confirmations for all purchases and redemptions of shares.⁶

Comments on the Notice were due by August 19, 2014.

Implementation Timeline

The SEC anticipates that the compliance date for the Reproposal and Diversification Proposal would be April 14, 2016 (18 months after the effective date of the July 2014 Money Market Fund Reform).

If you would like further detail on the Reproposal to remove ratings from Rule 2a-7, *see attached.*

⁴ See Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule, Investment Company Act Release No. 31184, 79 Fed. Reg. 47986 (proposed July 23, 2014). The SEC also adopted amendments to the Rule on July 23, 2014, as part of its broader money market fund reform ("July 2014 Money Market Fund Reform"). These amendments are discussed in the Fund Alert titled "What You Need to Know About Money Market Fund Reform," available at <http://www.stradley.com/newsletters.php?action=view&id=952>.

² The SEC considered the ratings standard in the Rule in a 2003 concept release, in a 2008 proposal to remove the ratings standard from the Rule, in proposed amendments to the Rule in 2009 and again in proposed amendments to the Rule in 2011. See References to Credit Ratings in Certain Investment Company Act Rules and Forms, Securities Act Release No. 9193, Investment Company Act Release No. 29592, 76 Fed. Reg. 12896 (proposed Mar. 3, 2011); Money Market Reform, Investment Company Act Release No. 28807, 74 Fed. Reg. 32688 (proposed June 30, 2009); References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28327, Advisers Act Release No. 2751, 73 Fed. Reg. 40124 (proposed July 1, 2008); Rating Agencies and the Use of Credit Ratings Under the Federal Securities Laws, Investment Company Act Release No. 26066 (June 4, 2003) (concept release).

The 2011 proposal proposed to (i) replace references to credit ratings in the Rule and Rule 5b-3 under the 1940 Act with alternative standards of creditworthiness; (ii) adopt new Rule 6a-5 under the 1940 Act, which would establish a creditworthiness standard (for purchase of certain debt securities by business and industrial development companies) to replace the credit rating reference in Section 6(a)(5) removed by the Dodd-Frank Act; (iii) eliminate required disclosures of credit ratings in Form N-MFP; and (iv) remove the requirement that credit ratings be used when portraying credit quality in shareholder reports from forms N-1A, N-2 and N-3 under the Securities Act of 1933, as amended, and the 1940 Act. The SEC has already adopted certain of these proposals. See Removal of Certain References to Credit Ratings Under the Investment Company Act, Securities Act Release No. 9506, Investment Company Act Release No. 30847, 79 Fed. Reg. 1316 (Dec. 27, 2013) (adopting amendments removing references to credit ratings in Rule 5b-3 and eliminating the required use of credit ratings in forms N-1A, N-2 and N-3); Purchase of Certain Debt Securities by Business and Industrial Development Companies Relying on an Investment Company Act Exemption, Investment Company Act Release No. 30268, 77 Fed. Reg. 70117 (Nov. 19, 2012) (adopting new Rule 6a-5). The remaining proposals are considered in

the Reproposal – elimination of certain references to ratings in the Rule and Form N-MFP.

³ The board may delegate the credit quality determination to the investment adviser and typically does so. This Fund Alert refers to duties typically delegated to the adviser as being performed by the adviser rather than by the fund or the fund's board.

⁴ See Karrie McMillan, General Counsel, Investment Company Institute, SEC No-Action Letter (Aug. 9, 2010).

⁵ Generally, funds must limit their investments in the securities of any one issuer of a first-tier security (other than U.S. government securities) to no more than five percent of total assets and limit their investments in securities subject to demand feature or a guarantee to no more than 10 percent of total assets from any one provider.

⁶ This permission is subject to certain conditions set forth in Rule 10b-10(b)(2) and (3). Specifically, Rule 10b-10(b)(2) requires a broker-dealer to send to a customer, within five business days after the end of each monthly period, a written statement disclosing each purchase or redemption effected for or with, and each dividend or distribution credited to or reinvested for, the account of such customer during the month; the date of such transaction; the identity, number and price of any securities purchased or redeemed by such customer in each such transaction; the total number of shares of such securities in such customer's account; and any remuneration received or to be received by the broker or dealer in connection therewith. Rule 10b-10(b)(2) also requires that any other information required by Rule 10b-10(a) be furnished upon written request. The written statement required by Rule 10b-10(b)(2) may be delivered to some other person designated by the customer for distribution to the customer. Rule 10b-10(b)(3) requires that such customer is provided with prior notification in writing disclosing the intention to send the written information referred to in Rule 10b-10(b)(1) in lieu of an immediate confirmation.



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SOME FACTORS WHICH MIGHT BE INCLUDED IN A MINIMAL CREDIT RISK DETERMINATION

The Release lists the following factors as examples of components of the credit risk evaluation.

- the issuer or guarantor's financial condition, *i.e.*, analysis of recent financial statements, including trends relating to cash flow, revenue, expenses, profitability, short-term and total debt service coverage, and leverage (including financial leverage and operating leverage).
- the issuer or guarantor's liquidity, including bank lines of credit and alternative sources of liquidity.
- the issuer or guarantor's ability to react to future events, including a discussion of a "worst case scenario," and its ability to repay debt in a highly adverse situation.
- the strength of the issuer or guarantor's industry within the economy and relative to economic trends as well as the issuer or guarantor's competitive position within its industry (including diversification in sources of profitability, if applicable).

The Release also states that the board's evaluation could include an analysis of whether the price and/or yield of a security is similar to that of other securities in the fund's portfolio.

The Release lists the following additional possible factors relating to municipal securities:¹

- sources of repayment;
- issuer demographics (favorable or unfavorable), such as the type, size, diversity and growth or decline of the local government's tax base, including income levels of residents, and magnitude of economic activity;
- the issuer's autonomy in raising taxes and revenue;
- the issuer's reliance on outside revenue sources, such as revenue from a state or federal government entity; and
- the strength and stability of the supporting economy.

The Release lists the following additional possible factors relating to conduit securities:²

- analysis of the underlying obligor as described above for all securities except asset-backed securities (including asset-backed commercial paper).

The Release lists the following additional possible factors relating to asset-backed securities (including asset-backed commercial paper):³

¹ The Municipal Securities Rulemaking Board defines municipal securities as "a general term referring to a bond, note, warrant, certificate of participation or other obligation issued by a state or local government or their agencies or authorities (such as cities, towns, villages, counties or special districts or authorities)."

² Under the Rule, a conduit security means a security issued by a municipal issuer involving an arrangement or agreement entered into, directly or indirectly, with a person other than a municipal issuer, which arrangement or agreement provides for or secures repayment of the security.

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



- analysis of the underlying assets to ensure they are properly valued and that there is adequate coverage for the cash flows required to repay the asset-backed security under various market conditions;
- analysis of the terms of any liquidity or other support provided; and
- legal and structural analyses to determine that the particular asset-backed security involves no more than minimal credit risks for the fund.

The Release lists the following additional possible factors relating to other structured securities:⁴

- analysis of the issuer or obligor’s financial condition, as described above; and
- analysis of the protections for the fund provided by the legal structure of the security.

The Release lists the following additional possible factors relating to repurchase agreements that are “collateralized fully”:⁵

- an assessment of the creditworthiness of the counterparty, of the volatility and liquidity of the market for collateral, if the collateral is a government agency collateralized mortgage obligation or mortgage-backed security, or other non-standardized security; and the process for liquidating collateral.

The Release lists the following additional possible factors relating to repurchase agreements that are not fully collateralized:⁶

- a financial analysis and assessment of the minimal credit risk of the counterparty, as described above, without regard to the value of the collateral;
- consideration of the type of collateral accepted; and
- the ability of the fund to liquidate the collateral.

⁴ Other structured securities listed in the Release include variable rate demand notes, tender option bonds, extendible bonds, “step up” securities, or other structures. The Release describes each of these types of securities. A variable rate demand obligation (which includes variable rate demand notes) is a security for which the interest rate resets on a periodic basis and holders are able to liquidate their security through a “put” or “tender” feature, at par. A tender bond option is an obligation that grants the bondholder the right to require the issuer or specified third party acting as agent for the issuer to purchase the bonds, usually at par, at a certain time or times prior to maturity upon the occurrence of specified events or conditions. An extendible bond is a long-term debt security with an embedded option for either the investor or the issuer to extend its maturity date. To qualify as an eligible security under the rule, the issuer must not have the right to extend the maturity of the bond so that it is more than 397 days to maturity at any time. A “step up” security pays an initial interest rate for the first period, and then a higher rate for the following periods.

⁵ The U.S. Commodity Futures Trading Commission defines a repurchase agreement as a “transaction in which one party sells a security to another party while agreeing to repurchase it from the counterparty at some date in the future, at an agreed price.” Under the Rule, for a repurchase agreement to be “collateralized fully,” the collateral must consist entirely of cash items or Government securities.

⁶ For a definition of a repurchase agreement, *see id.*

**Unofficial Mark-Up of 2014 Version of Rule 2a-7
Reflecting Further Changes to Remove Ratings and Tighten Diversification Requirements,
as Proposed July 2014**

(a) *Definitions*—(1) *Acquisition (or acquire)* means any purchase or subsequent rollover (but does not include the failure to exercise a demand feature).

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

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

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

(5) *Collateralized fully* has the same meaning as defined in § 270.5b-3(c)(1) except that § 270.5b-3(c)(1)(iv)(C) ~~and (D)~~ shall not apply.

(6) *Conditional demand feature* means a demand feature that is not an unconditional demand feature. A conditional demand feature is not a guarantee.

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

(i) Fully and unconditionally guaranteed by a municipal issuer;

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

(iii) Related to a project owned and operated by a municipal issuer; or

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

(8) *Daily liquid assets* means:

(i) Cash;

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

(iii) Securities that will mature, as determined without reference to the exceptions in paragraph (i) of this section regarding interest rate readjustments, or are subject to a demand feature that is exercisable and payable, within one business day; or

(iv) Amounts receivable and due unconditionally within one business day on pending sales of portfolio securities.

(9) *Demand feature* means a feature permitting the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the later of the time of exercise or the settlement of the transaction, paid within 397 calendar days of exercise.

(10) *Demand feature issued by a non-controlled person* means a demand feature issued by:

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

(ii) A sponsor of a special purpose entity with respect to an asset-backed security.

~~(11) *Designated NRSRO* means any one of at least four nationally recognized statistical rating organizations, as that term is defined in section 3(a)(62) of the Securities Exchange Act of 1934 (15 U.S.C. 78e(a)(62)), that:~~

~~(i) The money market fund's board of directors:~~

~~(A) Has designated as an NRSRO whose credit ratings with respect to any obligor or security or particular obligors or securities will be used by the fund to determine whether a security is an eligible security; and~~

~~(B) Determines at least once each calendar year issues credit ratings that are sufficiently reliable for such use;~~

~~(ii) Is not an “affiliated person,” as defined in section 2(a)(3)(C) of the Act (15 U.S.C. 80a-2(a)(3)(C)), of the issuer of, or any insurer or provider of credit support for, the security; and~~

~~(iii) The fund discloses in its statement of additional information is a designated-~~

~~NRSRO, including any limitations with respect to the fund's use of such designation.~~

~~(1211) Eligible security means a security:~~

~~(i) With a remaining maturity of 397 calendar days or less that the fund's board of directors determines presents minimal credit risks, which determination must include a finding that the security's issuer has an exceptionally strong capacity to meet its short-term financial obligations;~~

~~NOTE to paragraph (a)(11)(i): For a discussion of the phrase "exceptionally strong capacity to meet its short-term financial obligations," see Investment Company Act Release No. 31184, (July 23, 2014).~~

~~(ii) That is issued by a registered investment company that is a money market fund; or~~

~~(i) A rated security with a remaining maturity of 397 calendar days or less that has received a rating from the requisite NRSROs in one of the two highest short-term rating categories (within which there may be sub-categories or gradations indicating relative standing); or~~

~~(ii) An unrated security that is of comparable quality to a security meeting the requirements for a rated security in paragraph (a)(12)(i) of this section, as determined by the money market fund's board of directors; provided, however, that: a security that at the time of issuance had a remaining maturity of more than 397 calendar days but that has a remaining maturity of 397 calendar days or less and that is an unrated security is not an eligible security if the security has received a long-term rating from any designated NRSRO that is not within the designated NRSRO's three highest long-term ratings categories (within which there may be sub-categories or gradations indicating relative standing), unless the security has received a long-term rating from the requisite NRSROs in one of the three highest rating categories.~~

~~(iii) In addition, in the case of a security that is subject to a demand feature or guarantee: (A) The guarantee has received a rating from a designated NRSRO or the guarantee is issued by a guarantor that has received a rating from a designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security to the guarantee, unless:~~

~~(1) The guarantee is issued by a person that, directly or indirectly, controls, is controlled by or is under common control with the issuer of the security subject to the guarantee (other than a sponsor of a special purpose entity with respect to an asset backed security);~~

~~(2) The security subject to the guarantee is a repurchase agreement that is collateralized fully; or~~

~~(3) The guarantee is itself iii) That is a government security; and.~~

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

~~(12) Event of insolvency has the same meaning as defined in § 270.5b-~~

3(c)(2). ~~(14) First tier security means any eligible security that:~~

~~(i) Is a rated security that has received a short term rating from the requisite NRSROs in the highest short term rating category for debt obligations (within which there may be sub-categories or gradations indicating relative standing);~~

~~(ii) Is an unrated security that is of comparable quality to a security meeting the requirements for a rated security in paragraph (a)(14)(i) of this section, as determined by the fund's board of directors;~~

~~(iii) Is a security issued by a registered investment company that is a money market fund;~~
or

~~(iv) Is a government security.~~

~~(1513) Floating rate security~~ means a security the terms of which provide for the adjustment of its interest rate whenever a specified interest rate changes and that, at any time until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

~~(1614) Government money market fund~~ means a money market fund that invests 99.5 percent or more of its total assets in cash, government securities, and/or repurchase agreements that are collateralized fully.

~~(1715) Government security~~ has the same meaning as defined in section 2(a)(16) of the Act (15 U.S.C. 80a-2(a)(16)).

~~(1816) Guarantee:~~

(i) Means an unconditional obligation of a person other than the issuer of the security to undertake to pay, upon presentment by the holder of the guarantee (if required), the principal amount of the underlying security plus accrued interest when due or upon default, or, in the case of an unconditional demand feature, an obligation that entitles the holder to receive upon the later of exercise or the settlement of the transaction the approximate amortized cost of the underlying security or securities, plus accrued interest, if any. A guarantee includes a letter of credit, financial guaranty (bond) insurance, and an unconditional demand feature (other than an unconditional demand feature provided by the issuer of the security).

(ii) The sponsor of a special purpose entity with respect to an asset-backed security shall be deemed to have provided a guarantee with respect to the entire principal amount of the asset-

backed security for purposes of this section, except paragraphs (a)(12)(iii) (definition of eligible security), (d)(2)(iii) (credit substitution), (d)(3)(iv)(A) (fractional guarantees) and (e) (guarantees not relied on) of this section, unless the money market fund’s board of directors has determined 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 quality (pursuant to paragraph (d)(2) of this section) or liquidity (pursuant to paragraph (d)(4) of this section) of the asset-backed security, and maintains a record of this determination (pursuant to paragraphs (g)(7) and (h)(6) of this section).

~~(1917)~~ *Guarantee issued by a non-controlled person* means a guarantee issued by ~~a~~ a ~~(i)~~ ~~A~~ person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the guarantee (*control* means “control” as defined in section 2(a)(9) of the Act) (15 U.S.C. 80a-2(a)(9)); ~~or~~.

~~(ii) A sponsor of a special purpose entity with respect to an asset backed security.~~
(2018) *Illiquid security* means a security that cannot be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund.

(2119) *Penny-rounding method* of pricing means the method of computing an investment company’s price per share for purposes of distribution, redemption and repurchase whereby the current net asset value per share is rounded to the nearest one percent.

~~(22) Rated security means a security that meets the requirements of paragraphs (a)(22)(i) or (ii) of this section, in each case subject to paragraph (a)(22)(iii) of this section:~~

~~(i) The security has received a short term rating from a designated NRSRO, or has been issued by an issuer that has received a short term rating from a designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is~~

~~comparable in priority and security with the security; or~~

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

~~(iii) A security is not a rated security if it is subject to an external credit support agreement (including an arrangement by which the security has become a refunded security) that was not in effect when the security was assigned its rating, unless the security has received a short term rating reflecting the existence of the credit support agreement as provided in paragraph (a)(22)(i) of this section, or the credit support agreement with respect to the security has received a short term rating as provided in paragraph (a)(22)(ii) of this section.~~

~~(2320) Refunded security~~ has the same meaning as defined in § 270.5b-3(c)(4). ~~(24)~~

~~Requisite NRSROs means:~~

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

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

~~(2521) Retail money market fund~~ means a money market fund that has policies and procedures reasonably designed to limit all beneficial owners of the fund to natural persons.

~~(26) Second tier security~~ means any eligible security that is not a first tier security.

~~(2722) Single state fund~~ means a tax exempt fund that holds itself out as seeking to maximize the amount of its distributed income that is exempt from the income taxes or

other taxes on investments of a particular state and, where applicable, subdivisions thereof.

~~(28~~23) *Tax exempt fund* means any money market fund that holds itself out as distributing income exempt from regular federal income tax.

~~(29~~24) *Total assets* means, with respect to a money market fund using the Amortized Cost Method, the total amortized cost of its assets and, with respect to any other money market fund, means the total value of the money market fund's assets, as defined in section 2(a)(41) of the Act (15 U.S.C. 80a-2(a)(41)) and the rules thereunder.

~~(30~~25) *Unconditional demand feature* means a demand feature that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security or securities.

~~(31~~26) *United States dollar-denominated* means, with reference to a security, that all principal and interest payments on such security are payable to security holders in United States dollars under all circumstances and that the interest rate of, the principal amount to be repaid, and the timing of payments related to such security do not vary or float with the value of a foreign currency, the rate of interest payable on foreign currency borrowings, or with any other interest rate or index expressed in a currency other than United States dollars.

~~(32) *Unrated security* means a security that is not a rated security.~~

~~(33~~27) *Variable rate security* means a security the terms of which provide for the adjustment of its interest rate on set dates (such as the last day of a month or calendar quarter) and that, upon each adjustment until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

~~(34~~28) *Weekly liquid assets* means:

(i) Cash;

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

(iii) Government securities that are issued by a person controlled or supervised by and acting as an instrumentality of the government of the United States pursuant to authority granted by the Congress of the United States that:

(A) Are issued at a discount to the principal amount to be repaid at maturity without provision for the payment of interest; and

(B) Have a remaining maturity date of 60 days or less.

(iv) Securities that will mature, as determined without reference to the exceptions in paragraph (i) of this section regarding interest rate readjustments, or are subject to a demand feature that is exercisable and payable, within five business days; or

(v) Amounts receivable and due unconditionally within five business days on pending sales of portfolio securities.

(b) *Holding out and use of names and titles*—(1) *Holding out*. It shall be an untrue statement of material fact within the meaning of section 34(b) of the Act (15 U.S.C. 80a-33(b)) for a registered investment company, in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Act, including any advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors that is required to be filed with the Commission by section 24(b) of the Act (15 U.S.C. 80a-24(b)), to hold itself out to investors as a money market fund or the equivalent of a money market fund, unless such registered investment company complies with this section.

(2) *Names*. It shall constitute the use of a materially deceptive or misleading name or

title within the meaning of section 35(d) of the Act (15 U.S.C. 80a-34(d)) for a registered investment company to adopt the term “money market” as part of its name or title or the name or title of any redeemable securities of which it is the issuer, or to adopt a name that suggests that it is a money market fund or the equivalent of a money market fund, unless such registered investment company complies with this section.

(3) *Titles.* For purposes of paragraph (b)(2) of this section, a name that suggests that a registered investment company is a money market fund or the equivalent thereof includes one that uses such terms as “cash,” “liquid,” “money,” “ready assets” or similar terms.

(c) *Pricing and Redeeming Shares—(1) Share price calculation.*

(i) The current price per share, for purposes of distribution, redemption and repurchase, of any redeemable security issued by a government money market fund or retail money market fund, notwithstanding the requirements of section 2(a)(41) of the Act (15 U.S.C. 80a-2(a)(41)) and of §§ 270.2a-4 and 270.22c-1 thereunder, may be computed by use of the amortized cost method and/or the penny-rounding method. To use these methods, the board of directors of the government or retail money market fund must determine, in good faith, that it is in the best interests of the fund and its shareholders to maintain a stable net asset value per share or stable price per share, by virtue of either the amortized cost method and/or the penny-rounding method. The government or retail money market fund may continue to use such methods only so long as the board of directors believes that they fairly reflect the market-based net asset value per share and the fund complies with the other requirements of this section.

(ii) Any money market fund that is not a government money market fund or a retail money market fund must compute its price per share for purposes of distribution, redemption and repurchase by rounding the fund’s current net asset value per share to a minimum of the

fourth decimal place in the case of a fund with a \$1.0000 share price or an equivalent or more precise level of accuracy for money market funds with a different share price (e.g. \$10.000 per share, or \$100.00 per share).

(2) *Liquidity fees and temporary suspensions of redemptions.* Except as provided in paragraphs (c)(2)(iii) and (v) of this section, and notwithstanding sections 22(e) and 27(i) of the Act (15 U.S.C. 80a-22(e) and 80a-27(i)) and § 270.22c-1:

(i) *Discretionary liquidity fees and temporary suspensions of redemptions.* If, at any time, the money market fund has invested less than thirty percent of its total assets in weekly liquid assets, the fund may institute a liquidity fee (not to exceed two percent of the value of the shares redeemed) or suspend the right of redemption temporarily, subject to paragraphs (c)(i)(A) and (B) of this section, if the fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines that the fee or suspension of redemptions is in the best interests of the fund.

(A) *Duration and application of discretionary liquidity fee.* Once imposed, a discretionary liquidity fee must be applied to all shares redeemed and must remain in effect until the money market fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines that imposing such liquidity fee is no longer in the best interests of the fund. Provided however, that if, at the end of a business day, the money market fund has invested thirty percent or more of its total assets in weekly liquid assets, the fund must cease charging the liquidity fee, effective as of the beginning of the next business day.

(B) *Duration of temporary suspension of redemptions.* The temporary suspension of redemptions must apply to all shares and must remain in effect until the fund's board of directors, including a majority of the directors who are not interested persons of the fund,

determines that the temporary suspension of redemptions is no longer in the best interests of the fund. Provided, however, that the fund must restore the right of redemption on the earlier of:

(1) The beginning of the next business day following a business day that ended with the money market fund having invested thirty percent or more of its total assets in weekly liquid assets; or

(2) The beginning of the next business day following ten business days after suspending redemptions. The money market fund may not suspend the right of redemption pursuant to this section for more than ten business days in any rolling ninety calendar day period.

(ii) *Default liquidity fees.* If, at the end of a business day, the money market fund has invested less than ten percent of its total assets in weekly liquid assets, the fund must institute a liquidity fee, effective as of the beginning of the next business day, as described in paragraphs (c)(2)(ii)(A) and (B) of this section, unless the fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines that imposing the fee is not in the best interests of the fund.

(A) *Amount of default liquidity fee.* The default liquidity fee shall be one percent of the value of shares redeemed unless the money market fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines, at the time of initial imposition or later, that a higher or lower fee level is in the best interests of the fund. A liquidity fee may not exceed two percent of the value of the shares redeemed.

(B) *Duration and application of default liquidity fee.* Once imposed, the default liquidity fee must be applied to all shares redeemed and shall remain in effect until the money market

fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines that imposing such liquidity fee is not in the best interests of the fund.

Provided however, that if, at the end of a business day, the money market fund has invested thirty percent or more of its total assets in weekly liquid assets, the fund must cease charging the liquidity fee, effective as of the beginning of the next business day.

(iii) *Government money market funds.* The requirements of paragraphs (c)(2)(i) and (ii) of this section shall not apply to a government money market fund. A government money market fund may, however, choose to rely on the ability to impose liquidity fees and suspend redemptions consistent with the requirements of paragraph (c)(2)(i) and/or (ii) of this section and any other requirements that apply to liquidity fees and temporary suspensions of redemptions (e.g., Item 4(b)(1)(ii) of Form N-1A (§ 274.11A of this chapter)).

(iv) *Variable contracts.* Notwithstanding section 27(i) of the Act (15 U.S.C. 80a-27(i)), a variable insurance contract issued by a registered separate account funding variable insurance contracts or the sponsoring insurance company of such separate account may apply a liquidity fee or temporary suspension of redemptions pursuant to paragraph (c)(2) of this section to contract owners who allocate all or a portion of their contract value to a subaccount of the separate account that is either a money market fund or that invests all of its assets in shares of a money market fund.

(v) *Master feeder funds.* Any money market fund (a "feeder fund") that owns, pursuant to section 12(d)(1)(E) of the Act (15 U.S.C. 80a-12(d)(1)(E)), shares of another money market fund (a "master fund") may not impose liquidity fees or temporary suspensions of redemptions under paragraphs (c)(2)(i) and (ii) of this section, provided however, that if a master fund, in which the feeder fund invests, imposes a liquidity fee or temporary suspension of redemptions

pursuant to paragraphs (c)(2)(i) and (ii) of this section, then the feeder fund shall pass through to its investors the fee or redemption suspension on the same terms and conditions as imposed by the master fund.

(d) *Risk-limiting conditions*—(1) *Portfolio maturity*. The money market fund must maintain a dollar-weighted average portfolio maturity appropriate to its investment objective; provided, however, that the money market fund must not:

- (i) Acquire any instrument with a remaining maturity of greater than 397 calendar days;
- (ii) Maintain a dollar-weighted average portfolio maturity (“WAM”) that exceeds 60 calendar days; or
- (iii) Maintain a dollar-weighted average portfolio maturity that exceeds 120 calendar days, determined without reference to the exceptions in paragraph (i) of this section regarding interest rate readjustments (“WAL”).

(2) *Portfolio quality*—(i) *General*. The money market fund ~~must~~shall limit its portfolio investments to those United States dollar-denominated securities that ~~the fund’s board of directors determines present minimal credit risks (which determination must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by a designated NRSRO) and that~~ are at the time of acquisition eligible securities.

~~(ii) *Second tier securities*. No money market fund may acquire a second tier security with a remaining maturity of greater than 45 calendar days, determined without reference to the exceptions in paragraph (i) of this section regarding interest rate readjustments. Immediately after the acquisition of any second tier security, a money market fund must not have invested more than three percent of its total assets in second tier securities.~~

~~(iii)~~ *Securities subject to guarantees.* A security that is subject to a guarantee may be determined to be an eligible security ~~or a first tier security~~ based solely on whether the guarantee is an eligible security ~~or first tier security, as the case may be.~~ provided however, that the issuer of the guarantee, or another institution, has undertaken to promptly notify the holder of the security in the event the guarantee is substituted with another guarantee (if such substitution is permissible under the terms of the guarantee).

~~(iv)~~ *Securities subject to conditional demand features.* A security that is subject to a conditional demand feature (“underlying security”) may be determined to be an eligible security ~~or a first tier security~~ only if:

(A) The conditional demand feature is an eligible security ~~or first tier security, as the case may be;~~

(B) At the time of the acquisition of the underlying security, the money market fund’s board of directors has determined that there is minimal risk that the circumstances that would result in the conditional demand feature not being exercisable will occur; and

(1) The conditions limiting exercise either can be monitored readily by the fund or relate to the taxability, under federal, state or local law, of the interest payments on the security; or

(2) The terms of the conditional demand feature require that the fund will receive notice of the occurrence of the condition and the opportunity to exercise the demand feature in accordance with its terms; and

~~(C) The underlying security or any guarantee of such security (or the debt securities of the issuer of the underlying security or guarantee that are comparable in priority and security with the underlying security or guarantee) has received either a short term rating or a long term rating, as the case may be, from the requisite NRSROs within the NRSROs’ two highest short-~~

~~term or long-term rating categories (within which there may be sub-categories or gradations indicating relative standing) or, if unrated, is determined to be of comparable quality by the money market fund's board of directors to a security that has received a rating from the requisite NRSROs within the NRSROs' two highest short-term or long-term rating categories, as the case may be.~~

(C) The fund's board of directors determines that the issuer of the underlying security or any guarantor of such security has a very strong capacity for payment of its financial commitments; and

(D) The issuer of the conditional demand feature, or another institution, has undertaken to promptly notify the holder of the security in the event the conditional demand feature is substituted with another conditional demand feature (if such substitution is permissible under the terms of the conditional demand feature).

(3) *Portfolio diversification*—(i) *Issuer diversification*. The money market fund must be diversified with respect to issuers of securities acquired by the fund as provided in paragraphs (d)(3)(i) and (d)(3)(ii) of this section, other than with respect to government securities ~~and securities subject to a guarantee issued by a non-controlled person.~~

(A) *Taxable and national funds*. Immediately after the acquisition of any security, a money market fund other than a single state fund must not have invested more than:

(1) Five percent of its total assets in securities issued by the issuer of the security, provided, however, that such a fund may invest up to twenty-five percent of its total assets in the ~~first tier~~ securities of a single issuer for a period of up to three business days after the acquisition thereof; provided, further, that the fund may not invest in the securities of more than one issuer in accordance with the foregoing proviso in this paragraph at any time; and

(2) Ten percent of its total assets in securities issued by or subject to demand features or guarantees from the institution that issued the demand feature or guarantee.

(B) *Single state funds.* Immediately after the acquisition of any security, a single state fund must not have invested:

(1) With respect to seventy-five percent of its total assets, more than five percent of its total assets in securities issued by the issuer of the security; and

(2) With respect to all of its total assets, more than ten percent of its total assets in securities issued by or subject to demand features or guarantees from the institution that issued the demand feature or guarantee.

~~(C) *Second tier securities.* Immediately after the acquisition of any second tier security, a money market fund must not have invested more than one half of one percent of its total assets in the second tier securities of any single issuer, and must not have invested more than 2.5 percent of its total assets in second tier securities issued by or subject to demand features or guarantees from the institution that issued the demand feature or guarantee.~~

(ii) *Issuer diversification calculations.* For purposes of making calculations under paragraph (d)(3)(i) of this section:

(A) *Repurchase agreements.* The acquisition of a repurchase agreement may be deemed to be an acquisition of the underlying securities, provided the obligation of the seller to repurchase the securities from the money market fund is collateralized fully and the fund's board of directors has evaluated the seller's creditworthiness.

(B) *Refunded securities.* The acquisition of a refunded security shall be deemed to be an acquisition of the escrowed government securities.

(C) *Conduit securities.* A conduit security shall be deemed to be issued by the person

(other than the municipal issuer) ultimately responsible for payments of interest and principal on the security.

(D) *Asset-backed securities—(1) General.* An asset-backed security acquired by a fund (“primary ABS”) shall be deemed to be issued by the special purpose entity that issued the asset-backed security, provided, however:

(i) *Holdings of primary ABS.* Any person whose obligations constitute ten percent or more of the principal amount of the qualifying assets of the primary ABS (“ten percent obligor”) shall be deemed to be an issuer of the portion of the primary ABS such obligations represent; and

(ii) *Holdings of secondary ABS.* If a ten percent obligor of a primary ABS is itself a special purpose entity issuing asset-backed securities (“secondary ABS”), any ten percent obligor of such secondary ABS also shall be deemed to be an issuer of the portion of the primary ABS that such ten percent obligor represents.

(2) *Restricted special purpose entities.* A ten percent obligor with respect to a primary or secondary ABS shall not be deemed to have issued any portion of the assets of a primary ABS as provided in paragraph (d)(3)(ii)(D)(1) of this section if that ten percent obligor is itself a special purpose entity issuing asset-backed securities (“restricted special purpose entity”), and the securities that it issues (other than securities issued to a company that controls, or is controlled by or under common control with, the restricted special purpose entity and which is not itself a special purpose entity issuing asset-backed securities) are held by only one other special purpose entity.

(3) *Demand features and guarantees.* In the case of a ten percent obligor deemed to be an issuer, the fund must satisfy the diversification requirements of paragraph (d)(3)(iii) of

this section with respect to any demand feature or guarantee to which the ten percent obligor's obligations are subject.

(E) *Shares of other money market funds.* A money market fund that acquires shares issued by another money market fund in an amount that would otherwise be prohibited by paragraph (d)(3)(i) of this section shall nonetheless be deemed in compliance with this section if the board of directors of the acquiring money market fund reasonably believes that the fund in which it has invested is in compliance with this section.

(F) *Treatment of certain affiliated entities—(1) General.* The money market fund, when calculating the amount of its total assets invested in securities issued by any particular issuer for purposes of paragraph (d)(3)(i) of this section, must treat as a single issuer two or more issuers of securities owned by the money market fund if one issuer controls the other, is controlled by the other issuer, or is under common control with the other issuer, provided that “control” for this purpose means ownership of more than 50 percent of the issuer's voting securities.

(2) *Equity owners of asset-backed commercial paper special purpose entities.* The money market fund is not required to aggregate an asset-backed commercial paper special purpose entity and its equity owners under paragraph (d)(3)(ii)(F)(1) of this section provided that a primary line of business of its equity owners is owning equity interests in special purpose entities and providing services to special purpose entities, the independent equity owners' activities with respect to the SPEs are limited to providing management or administrative services, and no qualifying assets of the special purpose entity were originated by the equity owners.

(3) *Ten percent obligors.* For purposes of determining ten percent obligors pursuant to paragraph (d)(3)(ii)(D)(1)(i) of this section, the money market fund must treat as a single person

two or more persons whose obligations in the aggregate constitute ten percent or more of the principal amount of the qualifying assets of the primary ABS if one person controls the other, is controlled by the other person, or is under common control with the person, provided that “control” for this purpose means ownership of more than 50 percent of the person’s voting securities.

(iii) *Diversification rules for demand features and guarantees.* The money market fund must be diversified with respect to demand features and guarantees acquired by the fund as provided in paragraphs (d)(3)(iii) and (d)(3)(iv) of this section, other than with respect to a demand feature issued by the same institution that issued the underlying security, or with respect to a guarantee or demand feature that is itself a government security.

(A) *General.* Immediately after the acquisition of any demand feature or guarantee, any security subject to a demand feature or guarantee, or a security directly issued by the issuer of a demand feature or guarantee, a money market fund must not have invested more than ten percent of its total assets in securities issued by or subject to demand features or guarantees from the institution that issued the demand feature or guarantee, subject to paragraphs (d)(3)(iii)(B) and (d)(3)(iii)(C) of this section.

(B) *Tax exempt funds.* Immediately after the acquisition of any demand feature or guarantee, any security subject to a demand feature or guarantee, or a security directly issued by the issuer of a demand feature or guarantee (any such acquisition, a “demand feature or guarantee acquisition”), a tax exempt fund, with respect to eighty-five percent of its total assets, must not have invested more than ten percent of its total assets in securities issued by or subject to demand features or guarantees from the institution that issued the demand feature or guarantee; provided that any demand feature or guarantee acquisition in excess of ten percent of

the fund's total assets in accordance with this paragraph must be a demand feature or guarantee issued by a non-controlled person.

~~(C) *Second tier demand features or guarantees.* Immediately after the acquisition of any demand feature or guarantee, any security subject to a demand feature or guarantee, a security directly issued by the issuer of a demand feature or guarantee, or a security after giving effect to the demand feature or guarantee, in all cases that is a second tier security, a money market fund must not have invested more than 2.5 percent of its total assets in securities issued by or subject to demand features or guarantees from the institution that issued the demand feature or guarantee.~~

(iv) *Demand feature and guarantee diversification calculations*—(A) *Fractional demand features or guarantees.* In the case of a security subject to a demand feature or guarantee from an institution by which the institution guarantees a specified portion of the value of the security, the institution shall be deemed to guarantee the specified portion thereof.

(B) *Layered demand features or guarantees.* In the case of a security subject to demand features or guarantees from multiple institutions that have not limited the extent of their obligations as described in paragraph (d)(3)(iv)(A) of this section, each institution shall be deemed to have provided the demand feature or guarantee with respect to the entire principal amount of the security.

(v) *Diversification safe harbor.* A money market fund that satisfies the applicable diversification requirements of paragraphs (d)(3) and (e) of this section shall be deemed to have satisfied the diversification requirements of section 5(b)(1) of the Act (15 U.S.C. 80a-5(b)(1)) and the rules adopted thereunder.

(4) *Portfolio liquidity.* The money market fund must hold securities that are sufficiently

liquid to meet reasonably foreseeable shareholder redemptions in light of the fund's obligations under section 22(e) of the Act (15 U.S.C. 80a-22(e)) and any commitments the fund has made to shareholders; provided, however, that:

(i) *Illiquid securities.* The money market fund may not acquire any illiquid security if, immediately after the acquisition, the money market fund would have invested more than five percent of its total assets in illiquid securities.

(ii) *Minimum daily liquidity requirement.* The money market fund may not acquire any security other than a daily liquid asset if, immediately after the acquisition, the fund would have invested less than ten percent of its total assets in daily liquid assets. This provision does not apply to tax exempt funds.

(iii) *Minimum weekly liquidity requirement.* The money market fund may not acquire any security other than a weekly liquid asset if, immediately after the acquisition, the fund would have invested less than thirty percent of its total assets in weekly liquid assets.

(e) *Demand features and guarantees not relied upon.* If the fund's board of directors has determined that the fund is not relying on a demand feature or guarantee to determine the quality (pursuant to paragraph (d)(2) of this section), or maturity (pursuant to paragraph (i) of this section), or liquidity of a portfolio security (pursuant to paragraph (d)(4) of this section), and maintains a record of this determination (pursuant to paragraphs (g)(3) and (h)(7) of this section), then the fund may disregard such demand feature or guarantee for all purposes of this section.

~~(f) Downgrades, defaults and other events—(1) Downgrades:~~

~~(i) General. Upon the occurrence of either of the events specified in paragraphs~~

~~(f)(1)(i)(A) and (B) of this section with respect to a portfolio security, the board of directors~~

~~of the money market fund shall reassess promptly whether such security continues to present minimal credit risks and shall cause the fund to take such action as the board of directors determines is in the best interests of the money market fund:~~

~~(A) A portfolio security of a money market fund ceases to be a first tier security (either because it no longer has the highest rating from the requisite NRSROs or, in the case of an unrated security, the board of directors of the money market fund determines that it is no longer of comparable quality to a first tier security); and~~

~~(B) The money market fund's investment adviser (or any person to whom the fund's board of directors has delegated portfolio management responsibilities) becomes aware that any unrated security or second tier security held by the money market fund has, since the security was acquired by the fund, been given a rating by a designated NRSRO below the designated NRSRO's second highest short term rating category.~~

~~(ii) *Securities to be disposed of.* The reassessments required by paragraph (f)(1)(i) of this section shall not be required if the fund disposes of the security (or it matures) within five business days of the specified event and, in the case of events specified in paragraph (f)(1)(i)(B) of this section, the board is subsequently notified of the adviser's actions.~~

~~(iii) *Special rule for certain securities subject to demand features.* In the event that after giving effect to a rating downgrade, more than 2.5 percent of the fund's total assets are invested in securities issued by or subject to demand features from a single institution that are second tier securities, the fund shall reduce its investment in securities issued by or subject to demand features from that institution to no more than 2.5 percent of its total assets by exercising the demand features at the next succeeding exercise date(s), absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money~~

~~market fund.~~

~~(2f)~~ *Defaults and other events*—(1) Defaults. Upon the occurrence of any of the events specified in paragraphs (f)~~(21)~~(i) through ~~(iviii)~~ of this section with respect to a portfolio security, the money market fund shall dispose of such security as soon as practicable consistent with achieving an orderly disposition of the security, by sale, exercise of any demand feature or otherwise, absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money market fund (which determination may take into account, among other factors, market conditions that could affect the orderly disposition of the portfolio security):

- (i) The default with respect to a portfolio security (other than an immaterial default unrelated to the financial condition of the issuer);
- (ii) A portfolio security ceases to be an eligible security;
- ~~(iii) A portfolio security has been determined to~~ e.g., no longer ~~present~~ presents minimal credit risks); or
- ~~(iviii)~~ An event of insolvency occurs with respect to the issuer of a portfolio security or the provider of any demand feature or guarantee.

~~(32)~~ *Notice to the Commission*. The money market fund must notify the Commission of the occurrence of certain material events, as specified in Form N-CR (§ 274.222 of this chapter).

~~(43)~~ *Defaults for purposes of paragraphs (f)(2) and (3) of this section*. For purposes of paragraphs (f)(2) and (3) of this section, an instrument subject to a demand feature or guarantee shall not be deemed to be in default (and an event of insolvency with respect to the security shall not be deemed to have occurred) if:

- (i) In the case of an instrument subject to a demand feature, the demand feature has been exercised and the fund has recovered either the principal amount or the amortized cost of

the instrument, plus accrued interest;

(ii) The provider of the guarantee is continuing, without protest, to make payments as due on the instrument; or

(iii) The provider of a guarantee with respect to an asset-backed security pursuant to paragraph (a)(18)(ii) of this section is continuing, without protest, to provide credit, liquidity or other support as necessary to permit the asset-backed security to make payments as due.

(g) *Required procedures.* The money market fund's board of directors must adopt written procedures including the following:

(1) *Funds using amortized cost.* In the case of a government or retail money market fund that uses the amortized cost method of valuation, in supervising the money market fund's operations and delegating special responsibilities involving portfolio management to the money market fund's investment adviser, the money market fund's board of directors, as a particular responsibility within the overall duty of care owed to its shareholders, shall establish written procedures reasonably designed, taking into account current market conditions and the money market fund's investment objectives, to stabilize the money market fund's net asset value per share, as computed for the purpose of distribution, redemption and repurchase, at a single value.

(i) *Specific Procedures.* Included within the procedures adopted by the board of directors shall be the following:

(A) *Shadow Pricing.* Written procedures shall provide:

(1) That the extent of deviation, if any, of the current net asset value per share calculated using available market quotations (or an appropriate substitute that reflects current market conditions) from the money market fund's amortized cost price per share, shall be calculated at least daily, and at such other intervals that the board of directors determines appropriate and

reasonable in light of current market conditions;

(2) For the periodic review by the board of directors of the amount of the deviation as well as the methods used to calculate the deviation; and

(3) For the maintenance of records of the determination of deviation and the board's review thereof.

(B) *Prompt Consideration of Deviation.* In the event such deviation from the money market fund's amortized cost price per share exceeds ½ of 1 percent, the board of directors shall promptly consider what action, if any, should be initiated by the board of directors.

(C) *Material Dilution or Unfair Results.* Where the board of directors believes the extent of any deviation from the money market fund's amortized cost price per share may result in material dilution or other unfair results to investors or existing shareholders, it shall cause the fund to take such action as it deems appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results.

(2) *Funds using penny rounding.* In the case of a government or retail money market fund that uses the penny rounding method of pricing, in supervising the money market fund's operations and delegating special responsibilities involving portfolio management to the money market fund's investment adviser, the money market fund's board of directors, as a particular responsibility within the overall duty of care owed to its shareholders, must establish written procedures reasonably designed, taking into account current market conditions and the money market fund's investment objectives, to assure to the extent reasonably practicable that the money market fund's price per share as computed for the purpose of distribution, redemption and repurchase, rounded to the nearest one percent, will not deviate from the single price established by the board of directors.

(3) ~~Securities for which maturity is determined by reference to demand features. In the case of a security for which maturity is determined by reference to a demand feature, Ongoing review of credit risks. The written procedures ~~shall~~must require the adviser to provide ongoing review of ~~the~~whether each security's ~~continued~~ (other than a government security) continues to present minimal credit risks, ~~and that. The~~ review must ~~be~~:~~

(i) Include an assessment of each security's credit quality, including the issuer's capacity to meet its short-term financial obligations; and

(ii) Be based on, among other things, financial data ~~for the most recent fiscal year~~ of the issuer of the portfolio security or provider of the guarantee or demand feature, as the case may be, and; in the case of a security subject to a conditional demand feature, the issuer of the security whose financial condition must be monitored under paragraph ~~(d)(2)(iviii)~~ of this section, whether such data is publicly available or provided under the terms of the security's governing ~~documentation~~documents.

(4) *Securities subject to demand features or guarantees.* In the case of a security subject to one or more demand features or guarantees that the fund's board of directors has determined that the fund is not relying on to determine the quality (pursuant to paragraph (d)(2) of this section), maturity (pursuant to paragraph (i) of this section) or liquidity (pursuant to paragraph (d)(4) of this section) of the security subject to the demand feature or guarantee, written procedures must require periodic evaluation of such determination.

(5) *Adjustable rate securities without demand features.* In the case of a variable rate or floating rate security that is not subject to a demand feature and for which maturity is determined pursuant to paragraph (i)(1), (i)(2) or (i)(4) of this section, written procedures shall require periodic review of whether the interest rate formula, upon readjustment of its interest

rate, can reasonably be expected to cause the security to have a market value that approximates its amortized cost value.

(6) *Ten percent obligors of asset-backed securities.* In the case of an asset-backed security, written procedures must require the fund to periodically determine the number of ten percent obligors (as that term is used in paragraph (d)(3)(ii)(D) of this section) deemed to be the issuers of all or a portion of the asset-backed security for purposes of paragraph (d)(3)(ii)(D) of this section; provided, however, written procedures need not require periodic determinations with respect to any asset-backed security that a fund's board of directors has determined, at the time of acquisition, will not have, or is unlikely to have, ten percent obligors that are deemed to be issuers of all or a portion of that asset-backed security for purposes of paragraph (d)(3)(ii)(D) of this section, and maintains a record of this determination.

(7) *Asset-backed securities not subject to guarantees.* In the case of an asset-backed security for which the fund's board of directors has determined that the fund is not relying on the sponsor's financial strength or its ability or willingness to provide liquidity, credit or other support in connection with the asset-backed security to determine the quality (pursuant to paragraph (d)(2) of this section) or liquidity (pursuant to paragraph (d)(4) of this section) of the asset-backed security, written procedures must require periodic evaluation of such determination.

(8) *Stress Testing.* Written procedures must provide for:

(i) *General.* The periodic stress testing, at such intervals as the board of directors determines appropriate and reasonable in light of current market conditions, of the money market fund's ability to have invested at least ten percent of its total assets in weekly liquid assets, and the fund's ability to minimize principal volatility (and, in the case of a money market

fund using the amortized cost method of valuation or penny rounding method of pricing as provided in paragraph (c)(1) of this section, the fund's ability to maintain the stable price per share established by the board of directors for the purpose of distribution, redemption and repurchase), based upon specified hypothetical events that include, but are not limited to:

(A) Increases in the general level of short-term interest rates, in combination with various levels of an increase in shareholder redemptions;

(B) ~~A~~ An event indicating or evidencing credit deterioration, such as a downgrade or default, of particular portfolio security positions, each representing various portions of the fund's portfolio (with varying assumptions about the resulting loss in the value of the security), in combination with various levels of an increase in shareholder redemptions;

(C) A widening of spreads compared to the indexes to which portfolio securities are tied in various sectors in the fund's portfolio (in which a sector is a logically related subset of portfolio securities, such as securities of issuers in similar or related industries or geographic region or securities of a similar security type), in combination with various levels of an increase in shareholder redemptions; and

(D) Any additional combinations of events that the adviser deems relevant.

(ii) A report on the results of such testing to be provided to the board of directors at its next regularly scheduled meeting (or sooner, if appropriate in light of the results), which report must include:

(A) The date(s) on which the testing was performed and an assessment of the money market fund's ability to have invested at least ten percent of its total assets in weekly liquid assets and to minimize principal volatility (and, in the case of a money market fund using the

amortized cost method of valuation or penny rounding method of pricing as provided in paragraph (c)(1) of this section to maintain the stable price per share established by the board of directors); and

(B) An assessment by the fund's adviser of the fund's ability to withstand the events (and concurrent occurrences of those events) that are reasonably likely to occur within the following year, including such information as may reasonably be necessary for the board of directors to evaluate the stress testing conducted by the adviser and the results of the testing. The fund adviser must include a summary of the significant assumptions made when performing the stress tests.

(h) *Record keeping and reporting*—(1) *Written procedures*. For a period of not less than six years following the replacement of existing procedures with new procedures (the first two years in an easily accessible place), a written copy of the procedures (and any modifications thereto) described in this section must be maintained and preserved.

(2) *Board considerations and actions*. For a period of not less than six years (the first two years in an easily accessible place) a written record must be maintained and preserved of the board of directors' considerations and actions taken in connection with the discharge of its responsibilities, as set forth in this section, to be included in the minutes of the board of directors' meetings.

(3) *Credit risk analysis*. For a period of not less than three years from the date that the credit risks of a portfolio security were most recently reviewed, a written record ~~of the determination that a portfolio security presents minimal credit risks and the designated NRSRO ratings (if any) used to determine the status of the security as an eligible security, first tier security or second tier security shall~~must be maintained and preserved in an easily accessible

place of the determination that a portfolio security is an eligible security, including the determination that it presents minimal credit risks at the time the fund acquires the security, or at such later times (or upon such events) that the board of directors determines that the investment adviser must reassess whether the security presents minimal credit risks.

(4) *Determinations with respect to adjustable rate securities.* For a period of not less than three years from the date when the assessment was most recently made, a written record must be preserved and maintained, in an easily accessible place, of the determination required by paragraph (g)(5) of this section (that a variable rate or floating rate security that is not subject to a demand feature and for which maturity is determined pursuant to paragraph (i)(1), (i)(2) or (i)(4) of this section can reasonably be expected, upon readjustment of its interest rate at all times during the life of the instrument, to have a market value that approximates its amortized cost).

(5) *Determinations with respect to asset-backed securities.* For a period of not less than three years from the date when the determination was most recently made, a written record must be preserved and maintained, in an easily accessible place, of the determinations required by paragraph (g)(6) of this section (the number of ten percent obligors (as that term is used in paragraph (d)(3)(ii)(D) of this section) deemed to be the issuers of all or a portion of the asset-backed security for purposes of paragraph (d)(3)(ii)(D) of this section). The written record must include:

(i) The identities of the ten percent obligors (as that term is used in paragraph (d)(3)(ii)(D) of this section), the percentage of the qualifying assets constituted by the securities of each ten percent obligor and the percentage of the fund's total assets that are invested in securities of each ten percent obligor; and

(ii) Any determination that an asset-backed security will not have, or is unlikely to have, ten percent obligors deemed to be issuers of all or a portion of that asset-backed security for purposes of paragraph (d)(3)(ii)(D) of this section.

(6) *Evaluations with respect to asset-backed securities not subject to guarantees.* For a period of not less than three years from the date when the evaluation was most recently made, a written record must be preserved and maintained, in an easily accessible place, of the evaluation required by paragraph (g)(7) of this section (regarding asset-backed securities not subject to guarantees).

(7) *Evaluations with respect to securities subject to demand features or guarantees.* For a period of not less than three years from the date when the evaluation was most recently made, a written record must be preserved and maintained, in an easily accessible place, of the evaluation required by paragraph (g)(4) of this section (regarding securities subject to one or more demand features or guarantees).

(8) *Reports with respect to stress testing.* For a period of not less than six years (the first two years in an easily accessible place), a written copy of the report required under paragraph (g)(8)(ii) of this section must be maintained and preserved.

(9) *Inspection of records.* The documents preserved pursuant to paragraph (h) of this section are subject to inspection by the Commission in accordance with section 31(b) of the Act (15 U.S.C. 80a-30(b)) as if such documents were records required to be maintained pursuant to rules adopted under section 31(a) of the Act (15 U.S.C. 80a-30(a)).

(10) *Website disclosure of portfolio holdings and other fund information.* The money market fund must post prominently on its website the following information:

(i) For a period of not less than six months, beginning no later than the fifth business

day of the month, a schedule of its investments, as of the last business day or subsequent calendar day of the preceding month, that includes the following information:

(A) With respect to the money market fund and each class of redeemable shares thereof:

(1) The WAM; and

(2) The WAL.

(B) With respect to each security held by the money market fund:

(1) Name of the issuer;

(2) Category of investment (indicate the category that identifies the instrument from among the following: U.S. Treasury Debt; U.S. Government Agency Debt; Non-U.S. Sovereign, Sub-Sovereign and Supra-National debt; Certificate of Deposit; Non-Negotiable Time Deposit; Variable Rate Demand Note; Other Municipal Security; Asset Backed Commercial Paper; Other Asset Backed Securities; U.S. Treasury Repurchase Agreement, if collateralized only by U.S. Treasuries (including Strips) and cash; U.S. Government Agency Repurchase Agreement, collateralized only by U.S. Government Agency securities, U.S. Treasuries, and cash; Other Repurchase Agreement, if any collateral falls outside Treasury, Government Agency and cash; Insurance Company Funding Agreement; Investment Company; Financial Company Commercial Paper; and Non-Financial Company Commercial Paper. If Other Instrument, include a brief description);

(3) CUSIP number (if any);

(4) Principal amount;

(5) The maturity date determined by taking into account the maturity shortening provisions in paragraph (i) of this section (*i.e.*, the maturity date used to calculate WAM under paragraph (d)(1)(ii) of this section);

(6) The maturity date determined without reference to the exceptions in paragraph (i) of this section regarding interest rate readjustments (*i.e.*, the maturity used to calculate WAL under paragraph (d)(1)(iii) of this section);

(7) Coupon or yield; and

(8) Value.

(ii) A schedule, chart, graph, or other depiction, which must be updated each business day

as of the end of the preceding business day, showing, as of the end of each business day during the preceding six months:

(A) The percentage of the money market fund's total assets invested in daily liquid assets;

(B) The percentage of the money market fund's total assets invested in weekly liquid assets; and

(C) The money market fund's net inflows or outflows.

(iii) A schedule, chart, graph, or other depiction showing the money market fund's net asset value per share (which the fund must calculate based on current market factors before applying the amortized cost or penny-rounding method, if used), rounded to the fourth decimal place in the case of funds with a \$1.000 share price or an equivalent level of accuracy for funds with a different share price (*e.g.*, \$10.00 per share), as of the end of each business day during the preceding six months, which must be updated each business day as of the end of the preceding business day.

(iv) A link to a website of the Securities and Exchange Commission where a user may obtain the most recent 12 months of publicly available information filed by the money market fund pursuant to § 270.30b1-7.

(v) For a period of not less than one year, beginning no later than the same business day on which the money market fund files an initial report on Form N-CR (§ 274.222 of this chapter) in response to the occurrence of any event specified in Parts C, E, F, or G of Form N-CR, the same information that the money market fund is required to report to the Commission on Part C (Items C.1, C.2, C.3, C.4, C.5, C.6, and C.7), Part E (Items E.1, E.2, E.3, and E.4), Part F (Items F.1 and F.2), or Part G of Form N-CR concerning such event, along with the

following statement: “The Fund was required to disclose additional information about this event [or “these events,” as appropriate] on Form N-CR and to file this form with the Securities and Exchange Commission. Any Form N-CR filing submitted by the Fund is available on the EDGAR Database on the Securities and Exchange Commission’s Internet site at <http://www.sec.gov>.”

(11) *Processing of transactions.* A government money market fund and a retail money market fund (or its transfer agent) must have the capacity to redeem and sell securities issued by the fund at a price based on the current net asset value per share pursuant to § 270.22c-1. Such capacity must include the ability to redeem and sell securities at prices that do not correspond to a stable price per share.

(i) *Maturity of portfolio securities.* For purposes of this section, the maturity of a portfolio security shall be deemed to be the period remaining (calculated from the trade date or such other date on which the fund’s interest in the security is subject to market action) until the date on which, in accordance with the terms of the security, the principal amount must unconditionally be paid, or in the case of a security called for redemption, the date on which the redemption payment must be made, except as provided in paragraphs (i)(1) through (i)(8) of this section:

(1) *Adjustable rate government securities.* A government security that is a variable rate security where the variable rate of interest is readjusted no less frequently than every 397 calendar days shall be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate. A government security that is a floating rate security shall be deemed to have a remaining maturity of one day.

(2) *Short-term variable rate securities.* A variable rate security, the principal amount of which, in accordance with the terms of the security, must unconditionally be paid in 397 calendar days or less shall be deemed to have a maturity equal to the earlier of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand.

(3) *Long-term variable rate securities.* A variable rate security, the principal amount of which is scheduled to be paid in more than 397 calendar days, that is subject to a demand feature, shall be deemed to have a maturity equal to the longer of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand.

(4) *Short-term floating rate securities.* A floating rate security, the principal amount of which, in accordance with the terms of the security, must unconditionally be paid in 397 calendar days or less shall be deemed to have a maturity of one day, except for purposes of determining WAL under paragraph (d)(1)(iii) of this section, in which case it shall be deemed to have a maturity equal to the period remaining until the principal amount can be recovered through demand.

(5) *Long-term floating rate securities.* A floating rate security, the principal amount of which is scheduled to be paid in more than 397 calendar days, that is subject to a demand feature, shall be deemed to have a maturity equal to the period remaining until the principal amount can be recovered through demand.

(6) *Repurchase agreements.* A repurchase agreement shall be deemed to have a maturity equal to the period remaining until the date on which the repurchase of the underlying

securities is scheduled to occur, or, where the agreement is subject to demand, the notice period applicable to a demand for the repurchase of the securities.

(7) *Portfolio lending agreements.* A portfolio lending agreement shall be treated as having a maturity equal to the period remaining until the date on which the loaned securities are scheduled to be returned, or where the agreement is subject to demand, the notice period applicable to a demand for the return of the loaned securities.

(8) *Money market fund securities.* An investment in a money market fund shall be treated as having a maturity equal to the period of time within which the acquired money market fund is required to make payment upon redemption, unless the acquired money market fund has agreed in writing to provide redemption proceeds to the investing money market fund within a shorter time period, in which case the maturity of such investment shall be deemed to be the shorter period.

(j) *Delegation.* The money market fund's board of directors may delegate to the fund's investment adviser or officers the responsibility to make any determination required to be made by the board of directors under this section other than the determinations required by paragraphs ~~(a)(11)(i) (designation of NRSROs)~~, (c)(1) (board findings), (c)(2)(i) and (ii) (determinations related to liquidity fees and temporary suspensions of redemptions), (f)(2) (defaults and other events), (g)(1) and (g)(2) (amortized cost and penny rounding procedures), and (g)(8) (stress testing procedures) of this section.

(1) *Written Guidelines.* The board of directors must establish and periodically review written guidelines (including guidelines for determining whether securities present minimal credit risks as required in ~~paragraph~~paragraphs (d)(2) and (g)(3) of this section) and procedures under which the delegate makes such determinations.

(2) *Oversight.* The board of directors must take any measures reasonably necessary (through periodic reviews of fund investments and the delegate's procedures in connection with investment decisions and prompt review of the adviser's actions in the event of the default of a security or event of insolvency with respect to the issuer of the security or any guarantee or demand feature to which it is subject that requires notification of the Commission under paragraph (f)(3) of this section by reference to Form N-CR (§ 274.222 of this chapter)) to assure that the guidelines and procedures are being followed.

FURTHER DETAIL ON THE REPROPOSAL TO REMOVE RATINGS

The Reproposal affects five elements of the Rule, each of which are designed to remove references to, or requirement of reliance on, credit ratings: (i) the determination of whether a security is an eligible security; (ii) the determination of whether a security is a first tier security; (iii) credit quality standards for securities with a conditional demand feature; (iv) requirements for monitoring securities with ratings downgrades and other credit events; and (v) stress testing.¹ The first two elements are combined into one in the Reproposal.

The Reproposal also revises Form N-MFP, the form funds file monthly with the SEC to disclose portfolio holdings and other information.

1. Eligible Securities

The 2011 Proposal contemplated a requirement for fund boards to (i) first, determine whether securities are eligible securities based on minimal credit risks; and (ii) second, distinguish between first and second tier securities based on subjective standards. Rather than requiring a two-part determination, the Reproposal would combine the two risk criteria into a single standard for determining whether a fund could invest in a security, limiting investments to securities in which the fund's board has determined present minimal credit risk, notwithstanding any rating the security may have received. Specifically, the definition of "Eligible Security" relating to ratings would be replaced, in relevant part, by a requirement that an "Eligible Security" is a security "[w]ith a remaining maturity of 397 calendar days or less that the fund's board of directors determines presents minimal credit risks, which determination includes a finding that the security's issuer has an exceptionally strong capacity to meet its short-term financial obligations."

As a result of the single standard and elimination of the distinction between first and second tier securities, the Reproposal removes the current prohibition on funds investing more than 3 percent of their portfolios in second tier securities (and no more than 1/2 percent in any one second-tier issuer), thereby theoretically permitting funds to invest in second tier securities to a greater extent.

Further, the Release indicates that if a fund does continue to consider ratings, the adviser may need to conduct due diligence regarding the ratings. Specifically, the Release indicates that in order for fund boards to continue to rely on ratings, the SEC would expect the fund board to "understand the particular [rating agency]'s methodology for determining the rating at issue and make an independent judgment of credit risks, and...consider any outside source's record with respect to evaluating the types of securities in which the fund invests."

Fund boards typically delegate the day-to-day responsibility for credit quality determinations under the Rule to the investment adviser. If the Reproposal is adopted, however, advisers and boards will need to consider whether their procedures reflect the revised standards and whether reports to the board need to be modified to reflect the revised standards. The SEC says a fund is expected to keep a written record of the minimal credit determination that includes the data considered with appropriate documentation to reflect the process and determination. The SEC also expects the record would address any factors considered and the analysis of those factors.

¹ The Reproposal also makes conforming amendments to the Rule's recordkeeping and reporting requirements.



2. Conditional Demand Features

Currently, the Rule provides that a long-term security subject to a conditional demand feature² (underlying security) may be considered an eligible security if (i) the conditional demand feature is an eligible security or a first tier security; and (ii) the underlying security (or its guarantee) has received either a short-term rating or a long-term rating within the highest two categories from the requisite nationally recognized statistical rating organizations (NRSROs) or is a comparable unrated security. The Reproposal requires a similar analysis, but, consistent with the Dodd-Frank Act, removes the requirement that the fund board consider the credit ratings of underlying securities and requires the adviser, instead, to determine that the conditional demand feature is an eligible security.³

The adviser would have to evaluate the long-term risk (or short-term risk, as applicable) of the underlying security and determine that it “has a very strong capacity for payment of its financial commitments.” The Release states that an issuer determined to have a very low risk of default and a capacity for payment of its financial commitments that is not significantly vulnerable to reasonably foreseeable events would satisfy the proposed standard. The Release further states that the SEC does not believe that securities rated in the third-highest category for long-term ratings (or comparable unrated securities) would satisfy the proposed standard. The Release also advises against investing in securities whose eligibility as portfolio securities depends on a demand feature that would terminate if downgraded by a single rating category.⁴

3. Monitoring Minimal Credit Risks

The 2011 Proposal would have revised provisions of the Rule requiring reassessment of whether a portfolio security poses minimal credit risks following a downgrade by substituting a more subjective requirement for reassessment when the board’s delegate “becomes aware of any credible information about a portfolio security or an issuer of a portfolio security that may suggest that the security is no longer a First Tier Security or a Second Tier Security.” The Reproposal, however, revises provisions of the Rule by replacing the requirement that a fund reassess credit risks of an issuer when a security has been downgraded by an NRSRO with the requirement that each fund adopt written procedures requiring the fund adviser to provide ongoing review of the credit quality of each portfolio security to determine that the security continues to present minimal credit risks.

The Release provides that such ongoing monitoring would include the determination of whether the issuer continues to have an exceptionally strong capacity to repay its short-term financial obligations. The review would also update the information used to make the initial minimal credit risk determination and would be based on, among other factors, financial data of the issuer.

The Reproposal eliminates the requirement that the board be notified about a security that receives a rating below second tier that the fund disposes of without a credit reassessment. The Release expressly provides that, nevertheless, as part of the board’s oversight of the investment adviser, the board should establish procedures for the adviser to notify the board should the adviser decide to keep a portfolio security that has been downgraded from second tier status.

² A conditional demand feature is defined as a demand feature that is not an unconditional demand feature. An unconditional demand feature, in turn, is defined as a demand feature that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security.

³ The Reproposal concerning conditional demand features reflects the same standard as in the 2011 Proposal, revised to reflect the Reproposal’s different minimal risk determination.

⁴ The Reproposal retains the current requirement that a security subject to a conditional demand feature is an eligible security only if at the time it is acquired, the fund’s board (or the board’s delegate) determines that there is minimal risk that the circumstances that would result in the conditional demand feature terminating will occur, and that either (i) the conditions limiting the demand feature’s exercise can be monitored, or (ii) the fund otherwise receives notice of the occurrence of a limiting condition and the opportunity to exercise the demand feature in accordance with its terms.

4. Stress Testing

The Rule currently requires stress testing based on certain hypothetical events, including downgrades of particular portfolio securities. The 2011 Proposal would have replaced the reference to ratings downgrades with a requirement that funds stress test their portfolios for an adverse change in the ability of an issuer to meet its short-term credit obligations. The Reproposal would replace the reference to ratings downgrades in the stress testing requirement with a hypothetical event designed to have a similar impact on a fund's portfolio, specifically, "an event indicating or evidencing credit deterioration ... of particular portfolio security positions, each representing various portions of a fund's portfolio (with varying assumptions about resulting loss in the value of the security) in combination with various levels of an increase in shareholder redemptions." The proposed rule gives downgrades and defaults as examples of such events.

5. Form N-MFP

The 2011 Proposal would have eliminated the form items requiring a fund to: (i) identify whether a portfolio security is a first tier or second tier security, or an unrated security, and (ii) identify the requisite NRSROs for each security. The Reproposal instead requires that each fund disclose, for each portfolio security: (i) each rating assigned by any NRSRO if the fund or its adviser subscribes to that NRSRO's services, as well as the name of the agency providing the ratings, and (ii) any other NRSRO rating that the fund's board of directors (or its delegate) considered in making its minimal credit risk determination, as well as the name of the agency providing the rating.

The Release provides that if a fund's adviser has considered more than one NRSRO rating in making a minimal credit risk determination for a particular portfolio security, the Form N-MFP disclosure would need to reflect each rating considered (in addition to each rating assigned by an NRSRO if the fund or its adviser subscribes to its services).