ROPES & GRAY

ALERT

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SEC Adopts Money Market Fund Reforms and Changes to Reporting Requirements for Large Liquidity Fund Advisers

On July 12, 2023, the SEC issued a release (the "Release") adopting rule and form amendments concerning money market funds under the 1940 Act. The amendments are intended to address problems experienced by certain money market funds in connection with the economic shock at the onset of the COVID-19 pandemic. The Release also amended Form PF, which is the confidential reporting form for investment advisers to private funds, to require additional information regarding the private liquidity funds they advise.

The summary section below provides an overview of the principal changes effected by the Release, including the key differences from the SEC's 2021 proposing release (the "proposing release," discussed in this Ropes & Gray Alert). A detailed discussion of the Release follows the summary.

SUMMARY

Increase Minimum Liquidity Requirements. For all money market funds, the Release increases (i) the daily liquid asset minimum to 25% of total assets (currently 10%) and (ii) the weekly liquid asset minimum to 50% of total assets (currently 30%).

Elimination of Redemption Gates. The Release eliminates the redemption gate provisions from Rule 2a-7 for all money market funds.

Liquidity Fees Instead of Swing Pricing. The Release did not adopt the proposing release's swing pricing requirements for institutional prime and institutional tax-exempt money market funds ("institutional funds"). Instead, if an institutional fund has total daily net redemptions that exceed 5% of the fund's net assets – or a smaller amount of net redemptions as the fund's board determines – the fund must (unless the *de minimis* exception applies) charge a mandatory liquidity fee to all shares that are redeemed at a price computed on that day.

- The mandatory liquidity fee amount must reflect the fund's good faith estimate (and supported by data) of liquidity costs the fund would incur if it sold a *pro rata* amount of each security in its portfolio to satisfy the amount of net redemptions, including (i) transaction costs and (ii) market impact costs for each security.
- No liquidity fee is required if the amount of the liquidity fee would be less than 0.01% of the gross value of the shares redeemed (*i.e., de minimis*).
- If a fund cannot make a good faith estimate (supported by data) of its liquidity costs, a default mandatory liquidity fee of 1% applies.

For all prime and tax-exempt money market funds, the Release adopts a discretionary liquidity fee so that liquidity fees remain an available tool to manage redemption pressures where a mandatory fee does not apply. Government money market funds may choose to rely on the ability to impose liquidity fees, as well.

Reverse Distribution Mechanisms. In a change from the proposing release, the Release authorizes stable-value government and retail funds, under certain circumstances, to use a "reverse distribution mechanism" to maintain a stable share price by reducing the number of their outstanding shares.

Disclosure. The Release amends Form N-CR and Form N-MFP to reflect new filing and reporting requirements.

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I. Elimination of Redemption Gates

Rule 2a-7 currently permits a money market fund to temporarily suspend redemptions (*i.e.*, impose a "gate") after crossing a specified liquidity threshold. Consistent with the proposing release, the Release eliminates money market funds' ability through Rule 2a-7 to impose gates. As proposed, the Release also eliminates associated disclosure and reporting requirements about a fund's ability to impose gates, or the actual imposition of gates.[1]

II. Liquidity Fee Requirements Instead of Swing Pricing

In General. Rule 2a-7 currently permits a money market fund to impose liquidity fees after crossing a specified liquidity threshold. The proposing release would have eliminated liquidity fees from Rule 2a-7. In the most significant change from the proposing release, the Release instead adopts a mandatory liquidity fee framework for institutional prime and institutional tax-exempt funds instead of the proposed swing pricing requirement. The Release states that the "mandatory liquidity fee will reduce operational burdens associated with swing pricing while still achieving many of the benefits we were seeking with swing pricing by allocating liquidity costs to redeeming investors in stressed periods." Appendix A (Table 1) contains a comparison of the proposing release's swing pricing requirements and the Release's mandatory liquidity fee framework.

In addition, the Release adopts a discretionary liquidity fee for all prime and tax-exempt money market funds so that liquidity fees remain an available tool to manage redemption pressures where a mandatory fee does not apply. Government money market funds may choose to rely on the ability to impose liquidity fees, as well. The proposing release did not contain a discretionary liquidity fee framework. Appendix A (Table 2) contains a comparison of existing Rule 2a-7's discretionary liquidity fee requirements and the Release's discretionary liquidity fee framework.

In both instances – a mandatory liquidity fee for institutional funds and a discretionary liquidity fee for non-institutional prime and tax-exempt (and government funds that choose to adopt a liquidity fee) – the Release eliminates the requirement of a liquidity fee being triggered by a money market fund's weekly liquid asset levels falling below a threshold.

The Release, like the proposing release, acknowledges that liquidity fees and swing pricing "can be economically equivalent in terms of charging redeeming investors for the liquidity costs they impose on a fund [because b]oth approaches allow funds to recapture the liquidity costs of redemptions to make non-redeeming investors whole." In addition, the Release states that, to the extent that existing Rule 2a-7 gives investors an incentive "to redeem quickly during periods of market stress to avoid potential costs from a fund's future sale of less liquid securities," the amendments "will reduce those first-mover incentives and the associated run risk."

Mandatory Liquidity Fee

Net Redemption Threshold. A mandatory liquidity fee is triggered by a net redemption threshold applied at the fund level, not on the share class level. Specifically, if an institutional fund has total daily net redemptions that exceed five percent of the fund's net assets – or a smaller amount of net redemptions as the fund's board determines – the fund must apply a liquidity fee to all shares that are redeemed at a price computed on that day, in the amount described below.

- Determination of daily net redemptions must be "based on flow information available within a reasonable period after the last computation of the fund's net asset value on that day." The Release notes that, in determining "when to calculate its net flows, a fund should consider historical data on when it typically receives flow information and may also consider the period of time needed to calculate and apply fees."

[1] *See* Items 4(b)(1)(ii) and 16(g) of current Form N-1A; Parts F and G of current Form N-CR.

- Permitting a fund's board (or its delegate) to use a smaller net redemption threshold than five percent to apply liquidity fees recognizes circumstances in which a smaller threshold would be appropriate to mitigate dilution of fund shareholders. For example, the Release states, "this may be the case when a fund holds a larger amount of less liquid investments or in times of stress."

- When a fund crosses the five-percent net redemption threshold, it must apply a liquidity fee to all shares that are redeemed at a price computed on that day, including redemptions that were received during early pricing periods before the five percent net redemption level was achieved and those that are eligible to receive a NAV computed on that day even if received by the fund after the last pricing period of the day.

  - The Release recognizes that the requirement to apply a liquidity fee to all shares redeemed on the day the threshold is crossed is likely to require some adjustments for funds that offer multiple NAV strikes per day. That is, there may be investors that redeem at a pricing period in the morning or early afternoon, before the fund knows that it has crossed the five-percent threshold for the day. A fund that offers multiple daily NAV strikes will have to develop a method for applying the fee to shares redeemed in an earlier pricing period on that day.[2]

Calculating the Mandatory Liquidity Fee. The amount of the liquidity fee must be a good faith estimate, supported by data, of the costs the fund would incur if it sold a *pro rata* amount of each security in its portfolio (a "vertical slice") to satisfy the amount of net redemptions, including:

- Transaction costs, including spread costs, such that the fund is valuing each security at its bid price, and any other charges, fees, and taxes associated with portfolio security sales; and

- Market impacts for each security, where the fund determines market impacts by:

  - Establishing a market impact factor for each security, which is a good faith estimate of the percentage change in the value of the security if it were sold, per dollar of the amount of the security that would be sold if the fund sold a *pro rata* amount of each security in its portfolio to satisfy the amount of net redemptions under current market conditions; and

  - Multiplying the market impact factor by the dollar amount of the security that would be sold. A fund may assume a market impact of zero for its daily liquid assets and weekly liquid assets.

When determining transaction costs and market impacts for each security, a fund may estimate costs and market impacts for each type of security with the same or substantially similar characteristics and apply those estimates to all securities of that type rather than analyze each security separately.

De Minimis Exception. A fund is not required to apply a liquidity fee if the amount of the fee, when calculated in the manner described above, would be less than one basis point (0.01%) of the gross value of the shares redeemed.

Inability to Make a Good Faith Estimate. If the costs of selling a *pro rata* amount of each portfolio security cannot be estimated in good faith and supported by data, the liquidity fee amount is one percent of the value of shares redeemed.

[2] The Release suggests some approaches to address this issue, including (i) applying the liquidity fee charge to the remaining balance in an investor's account if the investor did not redeem the full amount of its shares in the fund, (ii) holding back a portion of the redemption proceeds until the end of the day when the liquidity fee determination is made and (iii) developing a mechanism for taking back a portion of redemption proceeds that the investor has already received. The Release also recognizes that some funds may choose to reduce the number of daily NAV strikes they offer or no longer offer multiple daily NAV strikes, thereby resulting in a reduction in access to liquidity compared to current practices.

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The Release notes that the default liquidity fee is intended to provide money market funds with the ability to apply a fee when they cannot make a good faith estimate of transaction and market impact costs, such as during periods of market stress.

Continued Availability of Discretionary Liquidity Fees. Rule 2a-7 currently permits prime and tax-exempt money market funds to impose a liquidity fee of up to two percent if the fund's weekly liquid assets fall below 30% of its total assets and the fund's board determines that the imposing a liquidity fee is in the fund's best interests. Government money market funds are currently permitted to choose to rely on the ability to impose liquidity fees.

The Release recognizes that a discretionary liquidity fee "provides money market fund boards with an additional tool to manage liquidity, particularly in times of stress" and, therefore, retains a discretionary liquidity fee provision in Rule 2a-7 for prime and tax-exempt money market funds (and government money market funds that to choose to rely on the ability to impose liquidity fees).

As noted above, authority to impose a discretionary liquidity fee in amended Rule 2a-7 is decoupled from a fund's weekly liquid assets. The Release states "the discretionary liquidity fee we are adopting is designed to allow a fund board (or its delegate) the flexibility to determine when a fee is necessary based on current market conditions and the specific circumstances of the fund."

- The amendments permit fund boards to impose a liquidity fee, if in the best interests of the fund, of up to two percent, and "do not require a particular approach to determining the level of a fee."
- Once imposed, a discretionary liquidity fee must be applied to all shares redeemed and must remain in effect until the fund's board determines that imposing the liquidity fee is no longer in the best interests of the fund.

Board Oversight. The Release amends Rule 2a-7 to permit fund boards to delegate mandatory and discretionary liquidity fee determinations to the fund's adviser or officers, subject to board-approved guidelines and oversight.

- If a fund board delegates liquidity fee determinations, the board must establish and periodically review written guidelines for determining the application and size of liquidity fees and procedures under which the delegate makes such determinations.
- The written guidelines "generally should specify the manner in which the delegate is to act with respect to any discretionary aspect of the liquidity fee mechanism (*e.g.,* whether the fund will apply a fee to a shareholder based on the shareholder's gross or net redemption activity for the relevant day)," and the board "will also need to periodically review the delegate's liquidity fee determinations."

Liquidity Fee-Related Disclosure

Form N-MFP. Amendments to Form N-MFP will require money market funds to report whether they applied a liquidity fee during the reporting period and, if so, information about each liquidity fee applied, including: (i) the date, (ii) the type of fee (*i.e.*, the fund had daily net redemptions of more than five percent in the case of a mandatory fee, or the fund's board (or delegate) made a best interests determination in the case of a discretionary fee), (iii) the amount of the fee as a percentage of the value of shares redeemed and (iv) in the case of a mandatory liquidity fee, whether the amount of the fee was based on good faith estimates of the fund's liquidity costs or was a default fee.[3] The remaining changes that the Release makes to Form N-MFP are summarized in Appendix B.

[3] The Release eliminates current reporting requirements on Form N-CR about the imposition of liquidity fees and whether a fee imposed under the current rule is a discretionary fee or a default fee.

- One Form N-MFP amendment impacts a money market fund's existing requirements to disclose and categorize its portfolio holdings on its website. Specifically, the Release adds to Form N-MFP two new categories to distinguish between U.S. Government agency notes that are coupon-paying and those that are "no-coupon discount" notes. A money market fund will be required to distinguish between the two categories of U.S. Government agency notes in the holdings disclosed on its website.

Form N-1A. Form N-1A will continue to require affected money market funds to provide narrative risk disclosure related to liquidity fees, as applicable, in their prospectuses, but the required disclosure has been changed to reflect the amended liquidity fee framework.[4] Thus, the required narrative disclosures concern both mandatory and discretionary liquidity fees and will vary depending upon the type of money market fund. With the elimination of gates, the required narrative disclosures regarding the suspension of redemptions are deleted.

A money market fund's Statement of Additional Information ("SAI") will be required to include liquidity fee disclosures outlining the new liquidity fee mechanism. The required liquidity fee disclosures will no longer be linked to weekly liquid asset thresholds, and references to the suspension of fund redemptions are deleted.

The SAI disclosure will continue to require a fund to report information about any liquidity fees imposed during the past 10 years, including the date a liquidity fee was imposed and the amount of the fee.[5] Because the Release eliminates the requirement for money market funds to report on Form N-CR when they impose liquidity fees, the current SAI requirements (to incorporate disclosure regarding information the fund reported on Form N-CR and to point investors to the fund's Form N-CR filing for additional information) are deleted.

Accounting Implications of Liquidity Fees. The Release states that the SEC's "continued position is that under normal circumstances, an investment in a money market fund that has the ability to impose a fee under [amended Rule 2a-7] qualifies as a 'cash equivalent' for purposes of U.S. GAAP." However, as is the case today, "if events that give rise to credit or liquidity issues for funds occur, shareholders would need to reassess if their investments in that money market fund would continue to meet the definition of a cash equivalent."

III. Amendments to Portfolio Liquidity Requirements

Increase of the Minimum Daily and Weekly Liquidity Requirements. Consistent with the proposing release, the Release adopts the requirements that all money market funds, immediately after acquisition of an asset, hold at least 25% of its total assets in "daily liquid assets" and at least 50% of its total assets in "weekly liquid assets."[6] Currently, the daily liquid assets and weekly liquid assets requirements in Rule 2a-7 are 10% and 30%, respectively.

Consequences of Falling Below Minimum Daily and Weekly Liquidity Requirements. As proposed, the Release amends Rule 2a-7 to require a money market fund to notify its board within one business day when the fund has less than 12.5% of its total assets invested in daily liquid assets or less than 25% of its total assets invested in weekly liquid assets (each, a "liquidity threshold event").

Following a liquidity threshold event, amended Rule 2a-7 requires a fund (i) to notify the board within one business day of the liquidity threshold event and (ii) to provide the board with a brief description of the facts and circumstances that led to the liquidity threshold event within four business days of the event.

Amendments to Liquidity Metrics in Stress Testing. At present, periodic stress testing for all money market funds includes a fund's ability to have invested at least 10% of its total net assets in weekly liquid assets under specified

[4] *See* Item 4(b) of amended Form N-1A.
[5] *See* Item 16(g) of amended Form N-1A.
[6] Tax-exempt money market funds remain exempt from the daily liquid asset requirements.

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hypothetical events described in Rule 2a-7. As proposed, for all money market funds, the Release eliminates testing at this 10% level. Instead, each fund will be required to determine the minimum level of liquidity it seeks to maintain during stress periods, identify that liquidity level in its written stress testing procedures, periodically test its ability to maintain such liquidity and provide the fund's board with a report on the results of such testing.

IV. Amendments Specifying Calculation of WAM and WAL

As proposed, the Release amends some Rule 2a-7 definitions to ensure that money market funds employ the same methodologies to calculate their "dollar-weighted average portfolio maturity" ("WAM") and "dollar-weighted average life maturity" ("WAL"). The Release amends Rule 2a-7 to require that money market funds calculate WAM and WAL based on the percentage of each security's market value in a fund's portfolio. This has the effect of prohibiting the practice employed by some money market funds of calculating WAM and WAL using the amortized cost of each portfolio security.

V. Amendments Related to Potential Negative Interest Rates

Conversion to a Floating Rate Fund. To help assure the operation of government or retail constant-NAV funds ("CNAV funds") that have converted to a floating share price due to negative interest rates, the proposing release would have amended Rule 2a-7 to expand a CNAV fund's obligations to confirm that the fund and its intermediaries can complete transactions if the fund converts to a floating share price.

Instead, the Release provides the following guidance regarding how funds and financial intermediaries generally should prepare for the possibility of a CNAV fund's conversion to a floating share price.

- The Release notes that intermediaries themselves may be subject to separate obligations to investors with regard to the distribution of proceeds received in connection with investments made or assets held on behalf of investors.

- CNAV money market funds generally should engage with their distribution network to consider how they would handle a negative interest rate environment, as the intermediaries' abilities to move to a four-digit NAV and apply a floating NAV or to process share cancellations is an important consideration in determining an approach that is in the best interests of the fund and its shareholders.

- More generally, it is important for a CNAV money market fund to understand the capabilities of its distribution network if the fund "breaks the buck." Funds generally should have a proactive plan for such an event that takes into account how different intermediaries in the fund's distribution network would address a fund's use of a floating NAV (*e.g.,* whether the intermediary has an automated process for processing transactions at a floating NAV or would need to manually process such transactions, as well as the likelihood that an intermediary using a manual approach would move investors to an alternative investment to mitigate the burdens of its manual process).

Reverse Distributions Allowed. Separately, the proposing release would have prohibited "reverse distribution mechanisms" (also referred to as "share cancellation" or "RDM") wherein a fund maintains a stable share price by reducing the number of its outstanding shares, despite losing value in a negative interest rate environment. Investors in such a fund would observe a stable share price but a declining number of shares for their investment.

In a change from the proposing release, the Release will permit a CNAV fund to reduce the number of its shares outstanding to maintain a CNAV per share with negative interest rates, subject to certain board determinations and disclosures to investors. Specifically, amended Rule 2a-7 will permit a CNAV fund to use an RDM only if:

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- The fund has negative gross yield as a result of negative interest rates (a "negative interest rate event");
- The fund's board of directors determines that reducing the number of the fund's shares outstanding is in the best interests of the fund and its shareholders. Among other things, in determining whether cancelling shares to maintain a stable NAV is in the best interests of the fund and its shareholders, the board generally should consider:
  - The capabilities of the fund's service providers and intermediaries to support the equitable application of the RDM across the fund's shareholders, including considering whether the operational and recordkeeping systems of the service providers and intermediaries are able to process and apply a pro rata reduction of shares in shareholder accounts on a daily basis.
  - Any state law limitations on share cancellation.
- Timely disclosure is provided to investors about the fund's share cancellation practices and their effects on investors, including:
  - Advance notice to investors in the fund's prospectus that the fund plans to use share cancellation in a negative interest rate event and the potential effects on investors; and
  - When the fund is cancelling shares, information in each account statement or in a separate writing accompanying each account statement identifying that such practice is in use and explaining its effects on investors (*i.e.*, a prominent statement that an investor is losing money when the fund cancels the investor's shares, as well as a clear and concise description of tax effects for shareholders).

The Release notes that, in determining the best interests of the fund and its shareholders, the board will also need to devote attention to applicable tax rules. In particular, the Release observes that, if fund shares are cancelled pursuant to an RDM, there can be no certainty that the tax treatment of distributions and shareholder tax basis would be unchanged. Accordingly, in determining whether cancelling shares to maintain a CNAV is in the best interests of the fund and its shareholders, the board generally should also consider various tax implications listed in the Release, taking into account the possibility that no new tax guidance or legislation may be forthcoming.[7]

In general, the Release states, a board may not delegate to the fund's investment adviser or officers the responsibility to determine if share cancellation is in the best interests of the fund. Moreover, a board generally should review its determination that an RDM is in the best interests of the fund and its shareholders if circumstances change, including if a negative interest rate event appears to be reasonably likely to occur in the near future.

Reverse Distributions Disclosure Requirements. A money market fund's prospectus must contain certain disclosure before a fund begins to use share cancellation. This disclosure, the Release states, "generally should be provided with sufficient advance notice to allow an investor to take into account information about the fund's possible use of share cancellation and the effects of that approach in the investor's investment decisions." The Release states:

- If the board's determination allowing the fund to use share cancellation occurs during a time when a negative interest rate environment does not appear to be reasonably likely to occur in the near future, the fund may include the required disclosures in any relevant part of the fund's prospectus;

[7] For brevity, the various tax implications are not repeated here.

- If a negative interest rate environment appears to be reasonably likely to occur in the near future, the fund must include disclosure about its possible use of share cancellation and the effects of share cancellation on investors in the summary prospectus, as share cancellation would be a component of the fund's principal investment strategies or principal risks when a fund is reasonably likely to use share cancellation in the near future;[8] and

- Beginning with the compliance date of the Tailored Shareholder Reports release[9] in July 2024, if a fund modifies its summary prospectus to disclose the reasonable likelihood of cancelling shares, or to disclose that the fund has begun to use share cancellation, then the fund also will be required to report information about this change as a material change in its next annual shareholder report.

The Release additionally describes the effects of share cancellation on the fund's financial disclosures under Regulation S-X.[10]

As a separate disclosure concern, the Release observes that, if a fund cancels shares, the fund also should consider effects on other information it provides and evaluate whether that information continues to present an accurate picture of the fund. As an example, the Release notes that when a fund that has cancelled shares calculates and provides its market-based NAV per share, the fund generally should use the number of shares outstanding it would have but for its cancelled shares. Using the actual number of shares that the fund has outstanding under these circumstances "would have the effect of inflating the fund's market-based NAV per share."

VI. Amendments to Form N-CR

Reporting of Liquidity Threshold Events. Money market funds are currently required to file public reports on Form N-CR upon the occurrence of certain specified events. As proposed, the Release amends Form N-CR to require a money market fund to report publicly when a liquidity threshold event has occurred.

- When reporting a liquidity threshold event, the fund's report on Form N-CR will be required to include (i) the initial date on which the fund falls below either the 12.5% daily liquid asset threshold or the 25% weekly liquid asset threshold, (ii) the percentage of the fund's total assets invested in both daily liquid assets and weekly liquid assets on the day of a liquidity threshold event and (iii) a brief description of the facts and circumstances leading to the liquidity threshold event.[11]

- Consistent with the existing timing requirements for Form N-CR, the amended form will require that a Form N-CR must be filed within one business day after the occurrence of a liquidity threshold event. However, a fund is permitted to file an amended report providing the required brief description of the facts and circumstances leading to the liquidity threshold event up to four business days after the event.[12]

[8] *See* Item 4 of Form N-1A. The Release notes that, depending on when a fund believes that negative rates may be reasonably likely to occur relative to the fund's annual prospectus update, a fund may "sticker" its summary prospectus to provide this information.
[9] The Tailored Shareholder Reports release is described in a November 2022 Ropes & Gray Alert.
[10] The Release notes that under the requirements for disclosing the total distributions to shareholders in Rule 6-09(3)(c) of Regulation S-X, negative distributions attributable to an RDM would be "other sources" of distributions. Funds generally should disclose negative distributions attributable to an RDM separately from any other sources of distributions to shareholders in the statement of changes in net assets.
[11] As proposed, an additional report will be required if, for example, a fund initially drops below 25% weekly liquid assets and, then, on a subsequent day drops below 12.5% daily liquid assets.
[12] If a fund has daily liquid assets or weekly liquid assets continuously below the relevant threshold for consecutive business days after reporting an initial liquidity threshold event, the fund is not required to file additional Form N-CR reports to disclose that the same type of liquidity threshold event continues.

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Form N-CR Format. Money market funds will be required to file reports on Form N-CR in a custom eXtensible Markup Language ("XML")-based structured data language created specifically for reports on Form N-CR ("N-CR-specific XML"). Reports on Form N-CR are currently required to be filed in HTML or ASCII.

Other Form N-CR Amendments. To improve the identifying information for the registrant and series reporting an event using Form N-CR, the Release requires the registrant name, series name and legal entity identifiers ("LEIs"). The Release removes the reporting events that relate to redemption gates and liquidity fees because money market funds will no longer be permitted to impose gates, while other disclosure about the imposition of liquidity fees is more appropriate than Form N-CR disclosure under the adopted liquidity fee framework.

The Release also amends Part C of Form N-CR with respect to the provision of financial support to a money market fund. In particular, when the support involves the purchase of a security from the fund, amended Form N-CR requires the date that the fund acquired the security to be reported.

VII. Amendments to Form PF

In a January 2022 release (the "Form PF Release"), the SEC proposed a variety of amendments to Form PF,[13] including proposed changes to section 3 of the form that are intended to require large liquidity fund[14] advisers to report substantially the same information that the SEC (in the proposing release) had proposed to require registered money market funds to report on Form N-MFP.

With minor changes from the Form PF Release, the Release's amendments to Form PF are summarized in Appendix C.

VIII. Recordkeeping Requirements

The Release expands the records that a money market fund will be required to maintain. The Release requires money market funds to preserve for a period not less than six years from the end of the relevant fiscal year (the first two years in an easily accessible place) all schedules evidencing and supporting each computation of a mandatory or discretionary liquidity fee by a money market fund. If the fund applies a one percent default liquidity fee, the fund must preserve records supporting its determination that it cannot establish a good faith estimate of its liquidity costs. If a fund determines that its liquidity costs are *de minimis* and, therefore, the fund is not required to apply a liquidity fee, the fund must preserve records supporting how it determined that the costs would be less than one basis point.

Similarly, the guidelines for determining the application and size of discretionary liquidity fees and the procedures under which the board's delegate makes such determinations are required records, as are copies of any reports to the board in connection with the board's oversight and periodic review of the operation of the delegate's determinations.

IX. Effective and Compliance Dates

The effective date for the Release's amendments to Rule 2a-7, Rule 31a-2 (records) and Form N-1A is 60 days after publication of the Release in the *Federal Register*. That effective date determines the compliance dates for various provisions of the Release, as described below. As of the date of this Alert, the Release has not been published in the *Federal Register*.

Compliance Dates for Forms N-MFP, N-CR and PF; Website Posting Requirement. The effective date and compliance for the amendments to Forms N-MFP, N-CR and PF is June 11, 2024. The compliance date for distinguishing between

[13] The January 2022 Form PF release is described in a Ropes & Gray Alert.
[14] For purposes of Form PF, a "liquidity fund" is any private fund that seeks to generate income by investing in a portfolio of short-term obligations in order to maintain a stable net asset value per unit or minimize principal volatility for investors.

U.S. Government agency notes that are coupon-paying and those that are "no-coupon discount" notes in a fund's website categorization of its holdings also is June 11, 2024.

Compliance Dates for Mandatory and Discretionary Liquidity Fee Frameworks. The compliance date for the mandatory liquidity fee framework is twelve months after the effective date of amended Rule 2a-7 (*i.e.*, 60 days after publication of the Release in the *Federal Register* plus 12 months).

The compliance date for the discretionary liquidity fee framework is six months after the effective date of the amendments to Rule 2a-7 (*i.e.*, 60 days after publication of the Release in the *Federal Register* plus six months).

- All money market funds, including government money market funds that choose to rely on the discretionary liquidity fee framework, may begin to rely on the mandatory and discretionary liquidity fee provisions after the effective date of amended Rule 2a-7 and prior to the applicable compliance date.

Compliance Date for Liquidity and Maturity-Related Rule 2a-7 Amendments. The compliance date for the following amendments to Rule 2a-7 is six months after the effective date of the amendments to Rule 2a-7 (*i.e.*, 60 days after publication of the Release in the *Federal Register* plus six months) – (i) amendments to Rule 2a-7's portfolio liquidity requirements and (ii) amendments to specify the calculation of WAM and WAL.

No Compliance Date for Remaining Amendments to Rule 2a-7, Rule 31a-2 and Form N-1A. The amendments to Rule 2a-7 and Form N-1A that are not subject to additional compliance periods above, which includes removal of redemption gates, removal of the tie between liquidity fees and liquidity thresholds and the new provision allowing share cancellation under certain circumstances, will go into full effect 60 days after publication of the Release in the *Federal Register* without a separate compliance date. Consequently, funds will no longer be permitted to impose redemption gates under Rule 2a-7 as of that effective date. Similarly, the connection between liquidity fees and weekly liquid asset thresholds will be removed at that time.

The amendments to Rule 2a-7 permitting the use of share cancellation in a negative interest rate environment will become effective 60 days after publication of the Release in the *Federal Register*. As a result, funds could begin to use share cancellation after this date, provided they meet amended Rule 2a-7's conditions for using share cancellation.

The amendments to Rule 31a-2 to require money market funds to preserve records regarding their liquidity fee computations will become effective 60 days after publication of the Release in the *Federal Register*. Money market funds are not required to comply with the amended liquidity fee requirements in Rule 2a-7 until after that date, but the earlier effectiveness of the recordkeeping requirement will require that funds preserve records for any liquidity fees they may apply prior to the compliance date of the liquidity fee requirements.

X. Observations

1. Is there a difference? The proposing release and the Release both noted that liquidity fees and swing pricing can be economically equivalent. In both cases, charges to redeeming shareholders cause them to internalize the transaction and market impact costs that their redemptions otherwise would impose on non-redeeming shareholders. Both approaches are thus intended to reduce first-mover incentives and related run risks. Ultimately, the Release informs us, the SEC was persuaded by commenters that the "same goals are better achieved through a liquidity fee mechanism, particularly given that current rule 2a-7 includes a liquidity fee framework that funds are accustomed to and can build upon."

2. Are we done? As recently as April 2023, the Financial Stability Oversight Council (the "Council") published a release (described in a Ropes & Gray Alert) containing proposed interpretive guidance (the "Proposed Guidance") regarding the process the Council would employ to determine whether a nonbank financial company (*e.g.*, a money market fund) should be designated as subject to supervision by the Board of Governors of the Federal Reserve System (the "Federal

Reserve”), including the Federal Reserve’s prudential standards. The Proposed Guidance would reverse certain changes made during the Trump Administration to the nonbank financial company designation process and thereby make it easier for the Council to use its nonbank designation authority.

SEC Chair Gensler, who has a seat on the Council, released a public statement in connection with the Council’s Proposed Guidance in which he stated:

> I’m pleased to support today’s recommendation, which would reinvigorate this Council’s designation process – in line with Congress’s vision for our work.
>
> As important as today’s step is, I believe each of our agencies have important roles within our respective authorities to enhance the resiliency of the financial system. At the SEC, we’re working along with fellow Council members to do just that – enhancing the resiliency of the U.S. Treasury markets, money market funds, open-end funds, private funds, clearinghouses, dealers, and with regard to cybersecurity. (Emphasis added).

It is unknown whether the Council will act in the near future despite the Release. Whether Chair Gensler believes that regulations enhancing the resiliency of SEC registrants should come exclusively from the SEC is only speculation. The substance of supervision by the Federal Reserve, if any, for registered funds (which could start with money market funds) remains to be seen.

3. Will the abandonment of swing pricing be extended? The SEC’s abandonment of swing pricing for money market funds could mean that the SEC will similarly abandon the swing pricing portion of its November 2022 proposals (discussed in a Ropes & Gray Alert). Those proposals would require all registered open-end funds, except for money market funds and ETFs, to engage in swing pricing under certain conditions “to mitigate dilution of shareholders’ interests in a fund.”

The purported systemic risks posed by money market funds have been the subject of public debate and SEC rulemaking since the September 2008 collapse of Lehman Brothers. The same cannot be said for other types of open-end funds. In addition, the November 2022 proposals’ “hard close” requirements would fundamentally change the way open-end funds operate and interact with shareholders and intermediaries, resulting in sweeping and costly changes in the fund industry. Smaller benefits and greater costs resulting from requiring swing pricing may lead the SEC to abandon swing pricing for other open-end funds. That is, if the SEC decided not to implement swing pricing for money market funds, it raises the question of why it would decide to move forward with it for other types of open-end funds.

4. Implementation costs. The SEC believes mandatory liquidity fees will have smaller “operational burdens” than swing pricing especially in view of the existing Rule 2a-7 liquidity fee framework “that funds are accustomed to.” Nonetheless, the Release’s operational burdens are still going to be substantial. As described above, institutional funds that offer multiple daily NAV strikes will have to develop a method for applying the liquidity fee to shares redeemed in an earlier pricing period on that day. While the Release offered some potential untested solutions, the SEC acknowledged that some institutional funds may choose either to reduce their number of daily NAV strikes or no longer offer multiple daily NAV strikes, thereby resulting in a reduction in access to liquidity compared to current practices. Institutional funds and, ultimately, their investors will bear the costs of making these changes. It remains to be seen whether this proves economically feasible or, instead, results in a reduction in access to liquidity.

* * *

If you would like to learn more about the developments in this Alert, please contact your usual Ropes & Gray attorney contacts or click here.

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APPENDIX A

Table 1

Comparison of Proposed Swing Pricing and the Release's Mandatory Liquidity Fee

	Proposed Swing Pricing	Mandatory Liquidity Fee
Description of mechanism	The fund's NAV is adjusted downward by a swing factor when the fund has net redemptions.	A mandatory fee is charged to redeeming investors when the fund has net redemptions above 5% of net assets.
Affected funds	Institutional prime and institutional tax-exempt money market funds.	Institutional prime and institutional tax-exempt money market funds.
Affected investors	The NAV is adjusted downward for both redeemers and subscribers. Redeeming investors' redemption proceeds are reduced, and subscribing investors purchase at a discounted price, compared to the unadjusted NAV they both otherwise would have received.	Redeeming investors are charged a liquidity fee. The liquidity fee does not affect subscribing investors.
Threshold for applying a charge	At any level of net redemptions for a pricing period, the swing factor includes spreads and certain other transaction costs (*i.e.*, brokerage commissions, custody fees, and any other charges, fees, and taxes associated with portfolio security sales). If net redemptions for a pricing period exceed 4% of net assets divided by the number of pricing periods per day, or such smaller amount of net redemptions as the swing pricing administrator determines, the swing factor also includes market impact costs.	Fees are triggered when the fund has total daily net redemptions that exceed 5% of net assets based on flow information available within a reasonable period after the last computation of the fund's net asset value on that day, or such smaller amount of net redemptions as the board determines.
Charge duration and application	The price is adjusted for all shareholders transacting in the fund's shares during the relevant pricing period.	The fund must apply a liquidity fee to all shares that are redeemed at a price computed on the day the fund has total daily net redemptions that exceed 5% of net assets.
Charge size	The swing factor would be determined by making good faith estimates of the spread, other transaction and market impact costs the fund would incur, as applicable, if it were to sell a *pro rata* amount of each security in its portfolio to satisfy the amount of net redemptions.	The size of the fee generally is determined by making a good faith estimate of the spread, other transaction and market impact costs the fund would incur if it were to sell a *pro rata* amount of each security in its portfolio to satisfy the amount of net redemptions.

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	Proposed Swing Pricing	Mandatory Liquidity Fee
	Affected money market funds could estimate costs and market impact factors for each type of security with the same or substantially similar characteristics and apply those estimates to all securities of that type in the fund's portfolio, rather than analyze each security separately.	Affected money market funds can estimate costs and market impacts for each type of security with the same or substantially similar characteristics and apply those estimates to all securities of that type in the fund's portfolio, rather than analyze each security separately. If the estimated liquidity costs are less than 0.01% of the gross value of the shares redeemed, a fund is not required to apply a fee under the *de minimis* exception. If the fund cannot estimate the costs of selling a *pro rata* amount of each portfolio security in good faith and supported by data, a default liquidity fee of 1% of the gross value of shares redeemed applies.
Maximum charge	The swing factor has no upper limit.	The fee has no upper limit.
Party who administers the provision	The board must approve swing pricing policies and procedures. The swing pricing administrator is charged with administering the swing pricing requirement. The swing pricing administrator is the fund's investment adviser, officer, or officers responsible for administering the fund's swing pricing policies and procedures, as designated by the fund's board. The administrator can be an individual or a group of persons.	The board is responsible for administering the liquidity fee requirement, but the board can delegate this responsibility to the fund's investment adviser or officers, subject to written guidelines established and reviewed by the board and ongoing board oversight.

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Table 2
Comparison of Existing Discretionary Liquidity Fee and the Release's Discretionary Liquidity Fee

	Current Rule 2a-7 Discretionary Liquidity Fee	Release's Discretionary Liquidity Fee
Description of mechanism	A discretionary fee may be charged to redeeming investors when the fund's weekly liquid assets decline below 30% and the board determines that a fee is in the best interests of the fund.	Irrespective of liquidity or redemption levels, a discretionary fee is charged to redeeming investors when the board determines that the fee is in the best interests of the fund.
Affected funds	Prime and tax-exempt money market funds. Government money market funds may opt in.	Prime and tax-exempt money market funds. Government money market funds may opt in.
Affected investors	Redeeming investors are charged a liquidity fee. The liquidity fee does not affect subscribing investors.	Redeeming investors are charged a liquidity fee. The liquidity fee does not affect subscribing investors.
Threshold for applying a charge	If weekly liquid assets fall below 30%, then a fund may institute a fee if the board determines that the fee is in the best interests of the fund.	If the board determines that doing so is in the best interests of the fund, the board must impose a liquidity fee.
Duration and application of the charge	Once imposed, the discretionary fee must be applied to all shares redeemed and remain in effect until the fund's board determines that imposing a fee is not in the best interests of the fund. If the fund has invested 30% or more of its total assets in weekly liquid assets as of the end of a business day, the fund must cease charging a fee effective the beginning of the next business day.	Once imposed, the discretionary fee must be applied to all shares redeemed and remain in effect until the fund's board determines that imposing such fee is no longer in the best interests of the fund.

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Additional Amendments to Form N-MFP

The Release adopts, with modifications discussed below, the proposed Form N-MFP requirements regarding additional information about the composition and concentration of money market fund shareholders and about prime funds' sales of non-maturing investments. Amended Form N-MFP will require funds to report information about their application of liquidity fees. In addition, because amended Rule 2a-7 permits CNAV funds to use share cancellation in a negative interest rate environment, Form N-MFP requires reporting related to share cancellation.

Concentration Information. For all money market funds, the Release requires new information about the composition and concentration of money market fund shareholders. Specifically, with respect to shareholder concentration, amended Form N-MFP requires that money market funds disclose the percentage ownership of each person who owns of record or is known by the fund to own beneficially five percent or more of the shares outstanding in each class of its shares. As proposed, to address circumstances in which multiple investors are represented as a single shareholder of record as a result of omnibus accounts, the final amendments require funds to report beneficial owner information only to the extent that such beneficial ownership is known to the fund.

In a change from the proposing release, the Release will not require money market funds to disclose the name of each person who is known by the fund to own beneficially or of record five percent or more of the shares outstanding in the relevant class. Instead, Form N-MFP will require money market funds to report only the type of beneficial or record owner who owns five percent or more of the shares outstanding in the relevant class. Amended Form N-MFP includes the following categories of owner types from which filers will make the appropriate selection: retail investor, non-financial corporation, pension plan, nonprofit, state or municipal government entity (excluding governmental pension plans), registered investment company, private fund, depository institution or other banking institution, sovereign wealth fund, broker-dealer, insurance company and "other."

Classification of Shareholders – Institutional Funds. For institutional funds, the Release amends Form N-MFP to require information about the composition of a fund's shareholders by category. Specifically, Form N-MFP will require institutional funds to identify the percentage of investors within the each of the same categories listed above (Concentration Information) but excluding retail investors.

Prime Money Market Funds' Selling Activity. In addition, the Release adds a new Part D to Form N-MFP, requiring information about the gross amount of portfolio securities a prime money market fund sold or disposed of during the reporting period and categorized by the type of investment. The categories of investments mirror the categories of funds already used on Form N-MFP to identify month-end holdings (*e.g.*, certificate of deposit, non-negotiable time deposit, financial or non-financial company commercial paper or U.S. Treasury debt). To focus this disclosure on secondary market activity, the portfolio securities held by the fund to maturity are not reportable. Institutional funds that are tax-exempt funds are not required to complete new Part D.

Liquidity Fees. Consistent with the changes described above in the liquidity fee mechanism section (and in a change from the proposing release), the Release amends Form N-MFP to require money market funds to report the date on which the liquidity fee was applied, the type of liquidity fee, and the amount of the liquidity fee applied by the fund. At the same time, the Release deletes existing reporting requirements on Form N-CR related to the application of liquidity fees.

Share Cancellation. In a change from the proposing release, Rule 2a-7 permits CNAV funds to use share cancellation when interest rates and the fund's gross yield are negative, subject to certain conditions. Accordingly, the Release amendments to Form N-MFP will require a CNAV fund to report if it used share cancellation during the reporting period

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and, if so, the dollar value of shares cancelled, the number of shares cancelled and the dates on which it used share cancellation.

Repurchase Agreements. The Release amends Form N-MFP to require additional information about repurchase agreement transactions and to standardize how money market funds report certain related information. As amended, Form N-MFP requires each fund to identify (i) the name of the counterparty in a repurchase agreement, (ii) whether a repurchase agreement is centrally cleared and the name of the central clearing counterparty, if applicable, (iii) if a repurchase agreement was settled on a triparty platform and (iv) the CUSIP of the securities involved in the repurchase agreement. The Release's amendments also include "cash" as a category of investment that most closely represents the collateral in repurchase agreements. In a change from the proposing release, the amendments do not eliminate the ability of funds to aggregate certain required information when multiple securities of an issuer are subject to the repurchase agreement (*i.e*., funds will not be required to report disaggregated information about securities subject to a repurchase agreement).

No Reporting by Lot. The proposing release would have amended Form N-MFP to specify that, for purposes of reporting a fund's schedule of portfolio securities in Part C of Form N-MFP, filers are required to provide information separately for the initial acquisition of a security and any subsequent acquisitions of the security (lot-level reporting). The Release will not require lot-level reporting. Instead, Form N-MFP filers will continue to be permitted, but are not required, to report information separately for each lot.

Repurchase Agreements. As amended, Form N-MFP requires each fund to identify (i) the name of the counterparty in a repurchase agreement, (ii) whether a repurchase agreement is centrally cleared and the name of the central clearing counterparty, if applicable, (iii) if a repurchase agreement was settled on a triparty platform and (iv) the CUSIP of the securities involved in the repurchase agreement.

Type of Money Market Fund. Form N-MFP currently requires filers to indicate the category of money market fund. These categories include "Treasury," "Government/Agency," and "Exempt Government," among others. As amended, Form N-MFP eliminates these three category designations and replaces them with one "Government" category. To distinguish between Treasury funds and other government funds, the amended form includes a new subsection that requires government money market funds to indicate whether they typically invest at least 80% of the value of their assets in U.S. Treasury obligations or repurchase agreements collateralized by U.S. Treasury obligations. The definitions for "government money market fund" and "retail money market fund" also are added to Form N-MFP, which makes the form consistent with the definitions of these terms in Rule 2a-7.

Clarity on Type of Money of Fund. The Release adds a new item in Form N-MFP requiring filers to indicate whether the fund is established as a cash management vehicle for affiliated funds and accounts. Separately, to avoid ambiguity, the form is amended to require a fund to respond "yes" or "no" to whether it seeks to maintain a stable price per share.

Government Agency Notes. For each portfolio security, a fund is required to indicate on Form N-MFP the category of instrument, using a list of categories designated in the form. The Release adds a new category that distinguishes between U.S. Government agency notes that are coupon-paying and those that are "no-coupon discount" notes. This distinction is important because only agency discount notes with less than 60 days to maturity can be considered weekly liquid assets. The Release also makes a conforming change to the list of investment categories that a fund must use for purposes of disclosing information about its holdings on its website.

Fee Waiver Information. Currently, funds are required to provide the name of any person who paid for or waived all or part of the fund's operating expenses or management fees during the reporting period and the amount and nature of the fee and expense waiver or reimbursement. The Release amends this Form N-MFP item to require funds to report only the amount of any fee waiver or expense reimbursement during the reporting period.

Frequency of Reported Data. At present, a money market fund must prominently disclose on its website, as of the end of each business day during the preceding six months, the fund's percentage of total assets invested in daily liquid assets and in weekly liquid assets, as well as the fund's per-share NAV (including for each class of shares) and net shareholder flow. Currently, in monthly Form N-MFP reports, a money market fund must provide the same general information for each Friday during the month reported. The Release amends Form N-MFP to require a money market fund to provide this liquidity, per-share NAV and flow data for each business day of the month (instead of on a weekly basis) in its monthly report.

The Release also amends Form N-MFP to increase the frequency with which funds report certain yield information. Currently, funds must report seven-day gross yields (at the series level) and seven-day net yields (at the share class level) as of the end of the reporting period. Amended Form N-MFP requires funds to report this information for each business day.

Use of LEI (N/A). Form N-MFP currently provides that a filer must disclose the registrant's LEI, if available, and does not require the LEI of the series. The Release amends the form to require funds to identify the name and LEI for both the fund registrant and the series.

Separately, at present, money market funds must report the LEI that corresponds to a portfolio security, if the LEI is available. The Release amends Form N-MFP to clarify that funds should respond to an item request with "N/A" if the information is not applicable (*e.g.*, a company does not have an LEI). Another amendment changes the definition of LEI in Form N-MFP to remove language stating that, in the case of a financial institution that does not have an assigned LEI, a fund should instead disclose the RSSD ID assigned by the National Information Center of the Board of Governors of the Federal Reserve System, if any. As amended, the form provides "RSSD ID" as an additional category of "other identifiers" that a fund can use for relevant portfolio securities.

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Amendments to Form PF

Operational Information. Under current Form PF, advisers must report whether the liquidity fund uses certain methodologies to compute its net asset value. The Release replaces these questions with a requirement for advisers to report the information more directly, by requiring advisers to report whether the liquidity fund seeks to maintain a stable price per share and, if so, to provide the price it seeks to maintain. The Release also amends Form PF to remove current Question 54 of Form PF, which requires advisers to report whether the liquidity fund has a policy of complying with certain provisions of Rule 2a-7.

Assets and Portfolio Information. With respect to fund assets, amended Form PF (i) will require advisers to report cash separately from other categories when reporting assets and portfolio information concerning repo collateral, (ii) adopt an amended definition of the term "weekly liquid assets" to specify that the term includes "daily liquid assets" and (iii) will require advisers to report additional identifying information about each portfolio security, including the name of the counterparty of a repo. In addition:

- At present, for repos, it is not clear whether advisers should report the name of the counterparty of the repo, the name of the clearing agency (in the case of centrally cleared repos) or both. Amended Form PF addresses this ambiguity.

- If an adviser reports an "other unique identifier" in identifying a portfolio security, the adviser will be required to describe that identifier.

- The list of categories of investments that advisers will use to identify a portfolio security in Item E of section 3.505 is revised. Accordingly, amended Form PF will require advisers to distinguish between U.S. government agency debt categorized as a coupon-paying note and a no-coupon discount note.

Consistent with the amendments to Form N-MFP, the SEC will not (as proposed) require large liquidity fund advisers to provide information separately for initial and subsequent transactions relating to securities purchased or sold by their liquidity funds during the reporting period (lot-level reporting). In a related change from the Form PF Release, the amended form will continue to require an adviser to report the coupon, if applicable, when reporting the title of the issue.

Additional Repo Reporting. The final amendments will require advisers to provide clearing information for repos. However, in a change from the Form PF Release and consistent with the Release, amended Form PF will continue to permit the advisers to aggregate certain information if multiple securities of an issuer are subject to a repo.

Subscriptions/Redemptions. The Release amends to Item B of section 3 to require information about subscriptions and redemptions. Advisers must report the total gross subscriptions (including dividend reinvestments) and total gross redemptions for each month of the reporting period.

Financing Information. The Release amends Form PF to revise how advisers report financing information to indicate whether a creditor is based in the United States and whether it is a "U.S. depository institution," rather than a "U.S. financial institution," as section 3 currently provides. As amended, advisers will also be required to indicate whether a creditor is based outside the U.S. but will not have to indicate whether that non-U.S. creditor is a depository institution.

Investor Information. As amended by the Release, section 3 will require advisers to provide the following information for each investor that beneficially owns five percent or more of the reporting fund's equity (i) the type of investor and (ii) the percent of the reporting fund's equity owned by the investor. In a change from the Form PF Release, these amendments have a modification applicable when an adviser selects "other" as an investor category in response to this

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question. Unlike the proposal in the Form PF Release, the amended form will require the adviser to describe the investor further in its response to section 1, Question 4.

In addition, the Release adopts a new question that requires advisers to report whether the liquidity fund is established as a cash management vehicle for other funds or accounts that the adviser or the adviser's affiliates manage that are not cash management vehicles.

Disposition of Portfolio Securities. The Release adopts new Item F (Disposition of Portfolio Securities) to section 3 of Form PF requiring advisers to report information about the portfolio securities the liquidity fund sold or disposed of during the reporting period (not including portfolio securities that the fund held until maturity). Advisers will report the gross market value sold or disposed of for each category of investment.

Weighted Average Maturity and Weighted Average Life. The Release adopts revisions to the definitions of "WAM" and "WAL" to include an instruction to calculate these figures with the dollar-weighted average based on the percentage of each security's market value in the portfolio.

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