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SEC Adopts Amendments to Money Market Fund Rules

The Securities and Exchange Commission (“SEC”) has adopted amendments to the rules governing money market mutual funds (“money funds”) registered under the Investment Company Act of 1940, as amended (the “1940 Act”).¹ In response to the extreme turbulence in the money fund sector in 2007 and 2008, the amendments seek to reduce money funds’ vulnerability to loss. The SEC adopted most of the amendments that it proposed in June 2009, which mostly track recommendations made by the Investment Company Institute Money Market Working Group and submitted to the SEC on March 17, 2009. The amendments establish new liquidity standards and increase money funds’ obligations relating to the designation of ratings organizations and reporting. The SEC believes the amendments will make money funds more resilient to certain short-term market risks, and will provide greater investor protection if a fund is unable to maintain a stable net asset value (“NAV”). The revised rules also would permit a money fund that has “broken the buck” (*i.e.*, priced its securities below a stable NAV per share, typically \$1.00) to suspend redemptions, thereby allowing the orderly liquidation of the fund’s assets.

Importantly, the amendments do not eliminate the stable \$1.00 NAV for money funds. This was suggested as a possible option in the Obama Administration’s White Paper on Financial Regulatory Reform, issued on June 17, 2009. The SEC, in its release proposing amendments to the money fund rules, requested comments on whether money funds should move to the “floating NAV” approach used by other open-end investment companies. The SEC stated that it received more than 75 comments on this issue and that it continues to explore possible regulatory changes in light of the comments and its work with the President’s Working Group on Financial Markets. The SEC also stated that it expects to issue a release addressing these issues and proposing further money fund reform, although no timeframe has been set.

The SEC acknowledged that it also received comments suggesting that it mandate private liquidity insurance for money funds; however, it did not directly address the question of whether it supported a permanent federal insurance program for investors in money funds.

The new rules go into effect on May 5, 2010. A summary chart that compares the amended rules to the existing rules, and includes the relevant compliance dates is included at the end of this document.

¹ Money Market Fund Reform, Investment Company Act Release No. 29132 (February 23, 2010) (“Adopting Release”), available at <http://sec.gov/rules/final/2010/ic-29132.pdf>.

Credit Quality

In the face of strong opposition to its proposal to require money funds to invest only in the highest-quality, “first-tier” securities,² the SEC elected to reduce the amount of second-tier securities that a money fund can acquire from 5% to 3% of total assets. The SEC also reduced the amount of second-tier securities of any one issuer that a money fund can acquire from the greater of 1% of the fund’s total assets or \$1 million, to 0.50% of total assets. The SEC also limited money funds to acquiring only second-tier securities with remaining maturities of 45 days or less.

In response to a request for comments on a proposal to eliminate the use of NRSRO ratings, and instead rely solely on the manager’s determinations, the SEC stated that it had received strong support for retaining the references to NRSRO ratings. The SEC nevertheless amended Rule 2a-7 to require that each money fund’s board: (i) designate four or more NRSROs, any one or more of whose short-term credit ratings the fund uses to determine whether a security is an eligible security; and (ii) determine at least annually that the designated NRSROs issue credit ratings that are sufficiently reliable. In addition, a fund must identify the designated NRSROs in its statement of additional information. This requirement would insert money fund boards into the management of credit risk to an unprecedented degree.

The SEC also amended Rule 2a-7 to eliminate a requirement that an asset backed security (“ABS”) be rated by at least one NRSRO in order to be an eligible security. Therefore, funds may acquire an unrated ABS that otherwise meets the requirements of Rule 2a-7, including those requirements that apply to unrated securities.

Portfolio Maturity

The SEC adopted its proposed changes to Rule 2a-7’s maturity limits to reduce exposure to certain risks, including interest rate risk:

² A “first-tier security” is: (i) a rated security that has received the highest short-term rating from the requisite nationally recognized statistical rating organizations (“NRSROs”); (ii) a comparable unrated security, as determined by the fund’s board; (iii) a money market fund; or (iv) a Government security.

- **Weighted Average Maturity.** The SEC reduced a fund’s maximum dollar-weighted average maturity from 90 to 60 days.
- **Weighted Average Life.** A new maturity test will limit a fund’s weighted average life to 120 days (measured without regard to a security’s interest reset dates), thereby reducing the fund’s exposure to interest rate and credit risk.
- **Government Securities.** The amendments deleted a provision that currently permits a fund that relies exclusively on the penny-rounding method of pricing to acquire U.S. Government securities with remaining maturities of up to 762 days, rather than the 397-day limit otherwise imposed by the rule. As proposed, the maturity-shortening provision of the rule for variable-rate Government securities will require that the variable rate of interest is readjusted no less frequently than every 397 days, instead of 762 days.

Portfolio Liquidity

The SEC amended Rule 2a-7 to add three new provisions that address different aspects of portfolio liquidity. The SEC believes that these measures aimed at liquidity risks will better enable money funds to meet significant redemption demands.

- **Prohibition on Acquisition of Illiquid Securities.** Under the amended rule, a money fund cannot acquire illiquid securities if, immediately after the acquisition, the fund would hold over 5% of its total assets in illiquid securities. The previous limit was 10%. The SEC also amended Rule 2a-7 to define “illiquid security” to mean a security that cannot be sold or disposed of in the ordinary course of business within seven days at approximately the value ascribed to it by the money fund.
- **New Cash Test.** The amended rule’s new liquidity standards, described below, would be based on the fund’s legal right to receive cash within the prescribed time periods rather than the ability to find a buyer for the security.

- **Liquidity Standards:**
 - *General Liquidity Requirement.* A money fund must at all times hold highly liquid securities sufficient to meet reasonably foreseeable redemptions under: (i) its 1940 Act obligations; and (ii) any commitments made to shareholders, such as paying redemptions in less than seven days.
 - *Minimum Daily Liquidity Requirement (Taxable Money Funds only).* All taxable money funds must hold at least 10% of their total assets in “daily liquid assets.” The SEC had requested comments on proposed new definitions for retail and institutional funds, with the presumption that institutional funds would need more liquidity; however, the SEC stated that it has not identified an effective way to distinguish between types of money funds and thus would apply the same minimum liquidity standards to all money funds.
 - *Minimum Weekly Liquidity Requirement (All Money Funds).* Under the amended rule all money funds must hold at least 30% of their total assets in “weekly liquid assets.”
- **Stress Testing.** Under amended Rule 2a-7 the board of a money fund using the amortized cost method must adopt procedures for periodic stress testing of the fund’s portfolio—testing the ability to maintain a stable NAV based upon certain hypothetical events, at intervals that the board determines appropriate and reasonable in light of prevailing market conditions. These events include increases in short-term interest rates or shareholder redemptions, a security’s downgrade or default, and widening or narrowing of spreads between yields of an appropriate overnight rate benchmark and those of the fund’s securities.

Diversification

Although the SEC had requested comments on whether it should further restrict the diversification limits of the rule (e.g., whether the 5% issuer limit should be reduced to 3%), the SEC determined that the tightened limitation on exposure to second-tier securities would provide additional protection to the

stability of money funds. Therefore, no changes to the diversification limits were made, and it remains at 5%.

Repurchase Agreements

As proposed, the SEC adopted two amendments concerning investment in repurchase agreements (“repos”). The first amendment limits fund investment in repos to those collateralized by cash or Government securities in order to obtain special treatment under the diversification provisions of Rule 2a-7. The special treatment allows money funds to consider the acquisition of the repo as an acquisition of the underlying collateral. In the second amendment the SEC reinstates the requirement that the board or its delegate evaluate the creditworthiness of the counterparty, whether or not the repo is collateralized fully.

Disclosure of Portfolio Information

The SEC adopted new disclosure requirements for money funds, including increased frequency of reporting.

- **Public Website.** Money funds are required to: (1) disclose information about their portfolio holdings each month on their websites, which must be current as of the last business day of the previous month and no later than the fifth business day of the month; and (2) maintain the information for no less than six months.
- **Monthly SEC Reports.** New Rule 30b1-7 requires money funds to submit a monthly electronic filing to the SEC on new Form N-MFP with detailed portfolio holdings information, enabling the SEC to create a central database of portfolio holdings, which would enhance its ability to oversee money funds and respond to market events. The information will be available to the public 60 days after the end of the month to which the information pertains.
- **No Change to Form N-Q Reporting.** The SEC had proposed amendments that would have exempted money funds from filing schedules of investments pursuant to Form N-Q. However, the SEC determined that its revisions to the website disclosure requirements made the

proposed amendments to Rule 30b1-5 unnecessary. As a result of this change from the SEC's original proposal, funds must continue to file first and third fiscal quarter portfolio holdings reports on Form N-Q.

Processing of Transactions

Amended Rule 2a-7 requires that a fund (or its transfer agent) have the capacity to redeem and sell its securities at a price based on the fund's current NAV, including the capacity to sell and redeem shares at prices that do not correspond to the stable NAV. Money funds must have the operational capacity to "break the buck" and to continue to process investor transactions in an orderly manner, including the capacity to sell and redeem shares at prices that do not correspond to the stable \$1.00 NAV.

Exemption for Purchases by Affiliates

As proposed, the SEC amended Rule 17a-9 to permit a money fund's affiliates to purchase a distressed portfolio security from the fund, even if the security continues to be an "eligible security." The requirement that a security no longer be "eligible" in order to qualify under the rule compelled a number of money fund managers to seek no-action relief from the SEC staff during the height of the crisis in 2008. The amendment eliminates the need to seek such relief. When a money fund's affiliate purchases securities in reliance on Rule 17a-9, the fund must promptly notify the SEC of the transaction by e-mail. The affiliate must promptly remit to the fund any profit it realizes from the later sale of the security.

Fund Liquidation—New Rule 22e-3

New Rule 22e-3 under the 1940 Act permits money funds that have broken the buck, or that are at imminent risk of breaking the buck, to suspend redemptions and postpone the payment of proceeds to facilitate an orderly liquidation of the fund. The new rule replaces a temporary rule that provided a similar exemption under the now-expired Treasury Department's Money Market Fund Guarantee Program. Under the new rule, a fund may suspend redemptions if: (i) the board, including a majority of the independent directors, determines that the deviation between the fund's amortized cost NAV

and the market-based NAV may result in material dilution or other unfair results; (ii) the board, including a majority of the independent directors, irrevocably approves the liquidation of the fund; and (iii) the fund, prior to suspending redemptions, notifies the SEC of its decision to liquidate and suspend redemptions. A money fund that intends to be able to rely on Rule 22e-3 may need to update its prospectus to disclose the circumstances under which it may suspend redemptions. The new rule allows the SEC to rescind or modify the relief provided by the rule. Thus, the SEC could require funds to resume honoring redemptions. In a deviation from the proposed amendments, the SEC revised one of the conditions of the rule to provide that the board must have *irrevocably* approved the fund's liquidation. The SEC stated that this revision is designed to limit the availability of the rule to extraordinary circumstances, and to prevent a fund from merely temporarily suspending redemptions if the board subsequently revokes the decision to liquidate.

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Summary of Money Market Fund Regulatory Amendments, February 23, 2010

PROPOSAL	DESCRIPTION OF NEW OR AMENDED RULE	CHANGE FROM CURRENT RULE	COMPLIANCE DATES
<p>Quality Amended Rule: 2a-7(a)(12) Amended Rule: 2a-7(c)(4)(i)(C) Amended Rule: 2a-7(c)(3)(ii)</p>	<ul style="list-style-type: none"> • An asset-backed security (“ABS”) is no longer required to be rated to be considered an “eligible security.” • Money funds may invest up to 3% in “second-tier” securities. • Money funds may invest no more than 0.5% in any second-tier security of any one issuer. • Maximum maturity of any second-tier security is 45 days. 	<ul style="list-style-type: none"> • Only rated ABSs were eligible. • Money funds previously could invest up to 5% in “second-tier” securities. • Money funds previously could invest no more than greater of 1% or \$1 million in any second-tier security of any one issuer. • Maximum maturity of any second-tier security was 397 days. 	<p>May 28, 2010</p>
<p>Ratings Agencies Amended Rule: 2a-7(a)(11)</p>	<ul style="list-style-type: none"> • Boards must designate 4 nationally recognized statistical rating organizations (“NRSROs”). • Boards must determine annually that each designated NRSRO’s ratings are reliable. • A money fund must disclose its designated NRSROs in its statement of additional information (“SAI”). 	<p>No similar provision.</p>	<p>SAI disclosure required no later than December 31, 2010</p>
<p>Maturity New and Amended Rule: 2a-7(c)(2)(ii) 2a-7(c)(2)(iii) 2a-7(d)(1)</p>	<ul style="list-style-type: none"> • Imposes a 60-day weighted average maturity limit. • Limits the weighted average life of portfolio securities to 120 days. • Interest rates on variable-rate Government securities must be readjusted no less frequently than every 397 days. 	<ul style="list-style-type: none"> • Currently imposes a 90-day average maturity limit. • No similar provision. • Currently, penny-rounding money funds may acquire Government securities with remaining maturities (or interest reset dates) of up to 762 days. 	<p>June 30, 2010 June 30, 2010 June 30, 2010</p>

PROPOSAL	DESCRIPTION OF NEW OR AMENDED RULE	CHANGE FROM CURRENT RULE	COMPLIANCE DATES
<p>Liquidity New Rule: 2a-7(c)(5)</p> <p>2a-7(c)(5)(i)</p> <p>2a-7(c)(5)(ii)</p> <p>2a-7(c)(5)(iii)</p>	<ul style="list-style-type: none"> • Money funds must hold highly liquid securities sufficient to meet reasonably foreseeable redemptions and any commitments made to shareholders. • SEC expects money funds to adopt policies to ensure the foregoing. • Prohibits money funds from acquiring securities that are illiquid if after they are acquired the money fund would have invested more than 5% of its total assets in illiquid securities. • Exempts tax-exempt funds from the minimum daily liquidity requirements. <p>Each taxable money fund must invest at least 10% of its assets in cash, U.S. Treasury securities, or securities that can provide daily liquidity.</p> <p>All money funds are required to hold at least 30% of total assets in weekly liquid assets.</p>	<p>No similar provision.</p> <p>No similar provision.</p> <p>No similar provision.</p> <p>No similar provision.</p>	<p>May 28, 2010</p> <p>May 28, 2010</p> <p>May 28, 2010</p> <p>May 28, 2010</p>
<p>Stress Testing Amended Rule: 2a-7(c)(10)(v)(A)</p>	<p>Money funds using amortized cost method must adopt periodic stress testing procedures.</p>	<p>No similar provision.</p>	<p>May 28, 2010</p>
<p>Repurchase Agreements New and Amended Rule: 2a-7(a)(5)</p> <p>2a-7(c)(4)(ii)(A)</p>	<p>Money funds would be able to adopt “look-through” treatment only with respect to repos collateralized by cash or Government securities.</p> <p>Money funds must evaluate counterparty creditworthiness, regardless of whether repo is fully collateralized.</p>	<p>Currently, a fund may look through repos collateralized with cash, Government securities, <i>and other first-tier securities.</i></p> <p>No similar provision.</p>	<p>May 28, 2010</p> <p>May 28, 2010</p>
<p>Public Holdings Disclosure Amended Rule: 2a-7(c)(12)</p>	<p>Requires monthly holdings disclosure on fund website.</p>	<p>No similar provision.</p>	<p>October 7, 2010</p>

PROPOSAL	DESCRIPTION OF NEW OR AMENDED RULE	CHANGE FROM CURRENT RULE	COMPLIANCE DATES
<p>Monthly Filing of Holding Reports New Rule: 30b1-7</p>	<p>Requires monthly SEC filing of detailed holdings information on new Form N-MFP. Funds must continue to file first- and third-quarter portfolio reports to SEC on Form N-Q and file annual and semi-annual shareholder reports on Form N-CSR.</p>	<p>Currently, funds are <u>only</u> required to file first- and third- quarter portfolio reports to the SEC on Form N-Q and file annual and semi-annual shareholder reports on Form N-CSR</p>	<p>December 7, 2010</p>
<p>Transaction Processing Amended Rule: 2a-7(c)(13)</p>	<p>Funds must have the operational capacity to “break a buck” and continue to process transactions in an orderly manner at prices other than stable value NAV.</p>	<p>No similar provision.</p>	<p>October 31, 2011</p>
<p>Suspension of Redemptions New Rule: 22e-3</p>	<ul style="list-style-type: none"> • Funds may suspend redemptions upon breaking a buck in order to liquidate in an orderly manner. • The SEC may rescind or modify the relief provided by the rule. 	<p>Replaces temporary Rule 22e-3T, which provided a similar exemption under the now-expired Treasury Guarantee Program.</p>	<p>May 5, 2010</p>
<p>Affiliated Transactions Amended Rule: 17a-9</p>	<ul style="list-style-type: none"> • Permits affiliate to buy a security that has defaulted, even though the security continues to be an eligible security. • The affiliate must promptly remit to the fund any profit realized from a later sale. 	<p>Currently, an affiliate may only purchase a security that is no longer an eligible security.</p>	<p>May 5, 2010</p>