Amendments to Rules Governing Money Market Funds

BY ALLSPRING GLOBAL LIQUIDITY SOLUTIONS TEAM

On July 12, 2023, the Securities and Exchange Commission (SEC) approved amendments to Rule 2a-7 of the Investment Company Act of 1940, which governs money market funds. The amendments are designed to improve the resilience and transparency of money market funds. The amended rule includes the following changes:

- Increased portfolio minimum liquidity requirements
- Removal of temporary redemption gates and the link between portfolio liquidity and liquidity fees
- New liquidity fee framework
- Measures to address potential negative interest rate environment

Increased portfolio minimum liquidity requirements

Under the amended rule, minimum daily and weekly liquid asset requirements for all money market funds will be increased. The minimum daily liquid asset requirement will increase from 10% to 25%, and the minimum weekly liquid asset requirement will increase from 30% to 50%. The SEC believes this will provide a more substantial buffer to better equip money market funds to manage significant and rapid investor redemptions.

Removal of temporary redemption gates and the link between portfolio liquidity and liquidity fees

Currently under Rule 2a-7, a prime or tax-exempt money market fund may impose a liquidity fee or temporarily suspend redemptions if the fund’s weekly liquid assets fall below 30% and the fund’s board of directors determines that doing so would be in the fund’s best interest. The SEC has acknowledged that, in March 2020, the possibility of liquidity fees and/or redemption gates being imposed appears to have actually contributed to investors’ incentives to redeem from institutional prime money market funds. It also contributed to money market fund managers maintaining weekly liquid asset levels above the threshold rather than using those assets to meet redemptions.

The amended rule eliminates money market funds' ability to impose temporary redemption gates. It also removes the regulatory tie that permits money market funds to impose liquidity fees if their weekly liquid assets fall below a certain threshold. The SEC believes this will reduce investors' incentive to redeem and allow portfolio managers to use available fund liquidity during a stressed market event.

New liquidity fee framework

The amendments will require institutional prime and institutional tax-free money market funds to impose mandatory liquidity fees when a fund experiences daily net redemptions that exceed 5% of net assets, unless the fund's liquidity costs are de minimis. In addition, nongovernment money market funds may impose a discretionary liquidity fee if the fund's board determines that a fee is in the best interest of the fund. The SEC believes the amended liquidity fee framework will protect shareholders from dilution and more fairly allocate costs so that redeeming shareholders bear the costs of redeeming from the fund when liquidity in underlying short-term funding markets is costly.

Measures to address potential negative interest rate environment

Under the amendments, stable net asset value (NAV) money market funds will have the option to either convert to a floating NAV or use share class cancellation (referred to as a "reverse distribution mechanism" or "RDM") in the event market conditions result in negative fund yields. Under the original proposal, the SEC contemplated prohibiting share class cancellation but included it as an option for money market funds under the final amended rule.

Compliance timeline

October 2, 2023

- Removal of redemption gates
- Removal of the link between liquidity fees and liquidity thresholds
- Provision allowing share cancellation under certain circumstances

April 2, 2024

- Increased portfolio minimum liquidity requirements
- Discretionary liquidity fees for retail prime and tax-free funds

October 2, 2024

- Mandatory liquidity fees for institutional prime and tax-free funds

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For floating NAV money market funds: You could lose money by investing in the fund. Because the share price of the fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.

Retail

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