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Orrick: SEC Eliminates References to Credit Ratings in Money Market Fund Rules.

On September 16, 2015, the Securities and Exchange Commission (“SEC”) adopted revisions to Rule 2a-7, the primary rule governing money market funds. The amendments implement provisions of the Dodd-Frank Act that require federal agencies to replace references to credit ratings in regulations with alternative standards of credit-worthiness, and are consistent with the SEC’s goal of reducing its reliance on credit ratings.

Rule 2a-7 currently requires that money market funds may only invest in “eligible securities” that receive one of the two highest short-term credit ratings. The current rule also requires funds to invest at least 97% of their holdings in securities that receive the highest short-term credit ratings. Under the September 16 amendments, money market funds will now be required to invest in eligible securities that are determined to impose a “minimal credit risk” to the respective fund.

What is “minimal credit risk”? Funds will be required to determine “minimal credit risk” by using credit analysis factors related to the ability of the security’s issuer/guarantor/demand-feature provider to meet its financial obligations. The relevant factors include, but are not limited to:

- financial condition;
- sources of liquidity;
- ability to react to future market-wide or issuer/guarantor-specific events (including the ability to repay debt in a highly adverse situation); and
- strength of the issuer/guarantor’s industry within the economy and the issuer/guarantor’s competitive position in the industry.

The SEC also revised Form N-MFP, a form used by money market funds to report portfolio information to the SEC on a monthly basis. Pursuant to the revisions, money market funds will now be required to disclose credit ratings they used in making their minimal credit risk determination, as well as the agency that provided the rating.

Additionally, the SEC adopted revisions to Rule 2a-7’s diversification provision, which generally prohibit money market funds from investing more than 5% of their total assets in the securities of a single issuer. The current rule excludes from the diversification requirement securities that are subject to a guarantee by a “non-controlled person” (i.e. a person who does not control, is not controlled by, or under the common control of the security’s issuer). Under the September 16 amendments, however, money market funds that invest in any security subject to a guarantee will be required to comply with the rule’s issuer diversification requirement, regardless of whether the guarantor is a non-controlled person.

The revised rules become effective thirty days after they are published in the Federal Register and have a compliance date of October 14, 2016.

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The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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