A DEEP DIVE INTO MONEY MARKET FUND LIQUIDITY FEES

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US Asset Management and Investment Funds Alert

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EXECUTIVE SUMMARY

On 12 July 2023, the Securities and Exchange Commission (the SEC) adopted amendments to Rule 2a-7 under the Investment Company Act of 1940, as amended (the 1940 Act) (the Final Rule), which governs the structure and operation of money market funds (MMFs). The amendments, which were first proposed by the SEC in a December 2021 release (the Proposed Rule), reflect the SEC's concern over market stresses experienced in response to the COVID-19 pandemic in March 2020 and are intended to improve the resiliency and transparency of MMFs.

In a surprising change from the Proposed Rule, the SEC did not adopt the much criticized swing pricing proposals for institutional prime and institutional tax-exempt MMFs (Institutional MMFs) and instead adopted a revamped liquidity fee regime that will require mandatory liquidity fees for Institutional MMFs and allow all MMFs, including Institutional MMFs, to impose discretionary liquidity fees when determined to be in the best interest of the fund.

This alert provides a detailed discussion of the requirements for implementing and calculating the new mandatory liquidity fees, the application of discretionary liquidity fees, board obligations and responsibilities, and changes in regulatory reporting requirements related to this new liquidity fee structure. We also briefly touch on the potential implications of the SEC's determination to drop the swing pricing proposal for MMFs on the SEC's separate, and still outstanding, rule proposal that would require swing pricing for non-MMF mutual funds. For a summary of the Final Rule, please see our earlier client alert here. The Final Rule was published in the Federal Register on 3 August 2023 and is slated to go effective on 2 October 2023.

MANDATORY LIQUIDITY FEE REQUIREMENTS

Overview

The Final Rule amended Rule 2a-7's existing liquidity fee and redemption gates regime by removing the ability to impose a redemption gate and delinking the implementation of a liquidity fee from Rule 2a-7's weekly liquid asset requirement, which were determined to have unintended negative consequences on investor behavior during the market events of March 2020. Instead, the Final Rule will require Institutional MMFs to implement a liquidity fee when an Institutional MMF has daily net redemptions that exceed 5% of net assets (unless liquidity costs are de minimis, or less than 0.01% of the value of the shares redeemed). The SEC adopted these mandatory liquidity fees in an attempt to deter any first mover advantage; to mitigate potential dilution caused by large shareholder

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redemptions in times of market stress; and, with respect to the mandatory nature of these fees, to avoid a purely discretionary framework where MMFs may not have imposed a fee unless under severe and prolonged stress. The Final Rule also maintains the ability for all MMFs, including Institutional MMFs, to impose discretionary liquidity fees when determined to be in the best interests of the fund.

Additionally, unlike the current requirements—where liquidity fees are applied the next day after the crossing of the liquidity threshold—the Final Rule will require that liquidity fees be applied the same day when that 5% redemption threshold is reached, such that redeeming investors—and not remaining investors—bear the transactions costs of their redemption, mitigating dilution and potentially disincentivizing any potential first mover advantage. In a further change from the Proposed Rule, the liquidity fee mechanism will not differentiate between pricing periods throughout the day for funds that offer multiple net asset value (NAV) strikes daily, with the liquidity fee only required to be calculated once daily and applied to all investors who redeem that day regardless of when or how many times the NAV is calculated.

Comparison to the Current and Proposed Rule

Current Rule

Currently, MMFs are allowed to charge fees and impose gates (i.e., a suspension of redemptions) if their weekly liquid assets fall below 30% of total assets. The SEC stated publicly that it was concerned that the link between liquidity thresholds and liquidity fees and gates had unintended consequences that were felt in March 2020. The SEC suggested that in an attempt to maintain the liquidity thresholds, some portfolio managers sold longer dated, less liquid securities to meet redemptions rather than daily and weekly liquid assets, which resulted in transaction costs or dilution being borne by remaining investors.

Proposed Rule

In response to these concerns, the SEC issued the Proposed Rule in December 2021 that would have, among other things: (i) increased liquidity thresholds; (ii) removed redemption gates; and (iii) instead of linking liquidity fees to liquidity thresholds, required Institutional MMFs to: (a) impose a swing factor reflecting spread costs and other transaction costs of selling a vertical slice of the fund's portfolio during any pricing period in which there were net redemptions; and (b) consider market impact factors (or the potential decline in value of particular securities if sold) when net redemptions were greater than 4% of the fund's NAV.

Comments on the Proposed Rule

The Proposed Rule resulted in a wave of comments from the industry critical of the proposed implementation of swing pricing. In particular, many commenters questioned the potential dilution concerns raised by the SEC and the need for such a mechanism in MMFs that are managed to meet regular inflows and outflows often in excess of the thresholds. The industry also expressed concern regarding how the swing factor could be estimated and implemented with the ease suggested by the SEC given the time constraints and general lack of familiarity with swing pricing in MMFs and US mutual funds in general. Commenters raised concerns that if swing pricing were adopted as proposed, it would be implemented on a large number of trading days, and argued instead that, if swing pricing were to be implemented at all, it should be implemented only in times of considerable market stress.

In addition, several commenters noted that if swing pricing were to be adopted as proposed, many MMFs might have been required to impose swing pricing to meet redemptions even when no actual transaction costs were incurred, since MMFs typically have been able to satisfy redemptions either through the regularly anticipated

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maturation of portfolio securities or with cash on hand. Certain industry commenters also suggested that a discretionary liquidity fee delinked from liquidity thresholds may be preferable to swing pricing, as such fees are already part of the current rule and could be more easily understood by investors and implemented by the industry. Others suggested a more nuanced tiered liquidity fee, which could be implemented if redemptions exceeded a certain threshold (say, for example, 10%) and weekly liquid asset levels declined below certain designated thresholds.

Final Rule

In response to industry comments, the SEC ultimately determined to adopt mandatory liquidity fees instead of swing pricing for Institutional MMFs, conceding that swing pricing would be difficult to implement. The SEC cited the fact that liquidity fees would be more transparent with respect to the liquidity costs redeeming investors incur and that the industry generally would be familiar with the concept of liquidity fees, as liquidity fees are already a part of the current rule. The SEC ultimately concluded that mandatory liquidity fees would address the same dilution and first mover advantage concerns as its swing pricing proposal was intended to address, while being easier to implement than swing pricing.

In the Final Rule, the SEC largely rejected arguments that liquidity fees should be primarily discretionary, which the SEC found unpersuasive because fund boards have not implemented discretionary fees under the current rule. One of the commenter proposals that the SEC rejected was the tiered liquidity fee regime, in which liquidity fees would be imposed if redemptions exceeded, and weekly liquid asset levels fell below, designated thresholds because, in the SEC's estimation, doing so would encourage portfolio managers to hoard weekly liquid assets to avoid triggering mandatory fees and allow investors to time their redemptions to occur prior to hitting any liquidity threshold. Additionally, in response to suggestions that swing pricing or liquidity fees should be imposed only at times of market stress, the SEC noted its belief that limiting anti-dilution mechanisms to periods of market stress would be counterproductive as such a fee would likely not be triggered during the first wave of a liquidity crisis period, thus still leaving remaining shareholders to bear the expenses of the earliest redeeming shareholders.

Calculation of Mandatory Liquidity Fee

Unlike the current liquidity fee regime, the Final Rule is more specific in terms of how a fund determines its liquidity fee and does not include an upper limit on the liquidity fee that must be imposed. The Final Rule states that the mandatory liquidity fee will be calculated based on a good faith estimate of the costs the Institutional MMF would incur if the fund sold a pro rata amount of each security in its portfolio to satisfy the amount of net redemptions. As part of this calculation, a fund will need to estimate: (i) transaction costs (including spread costs and any other charges); (ii) fees; (iii) taxes associated with those security sales; and (iv) market impacts for each security. In a way, the calculation of a mandatory liquidity fee is very similar to swing pricing in the Proposed Rule, although in the form of a liquidity fee and imposed on days of increased net redemptions as opposed to any time there was a net redemption. In particular, although one of the major critiques of the Proposed Rule centered on the difficulty of estimating the costs of selling a pro rata amount of each security in a portfolio in order to implement swing pricing, the similar application of good faith estimates to determine mandatory liquidity fees has been retained under the Final Rule.

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Calculating Market Impact

As proposed, swing pricing would have required the imposition of market impact factors when net redemptions exceeded 4% of the fund's net assets, which commenters asserted could have occurred on a fairly regular basis. As a small concession, the SEC has increased this threshold to 5% of the fund's net assets in the Final Rule as the trigger for when a mandatory liquidity fee must be imposed. Similar to swing pricing under the Proposed Rule, in calculating the market impact for a liquidity fee, a fund must estimate the impact of selling a vertical slice of its portfolio to satisfy the amount of net redemptions. The Final Rule allows funds to estimate transaction 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—an approach that is consistent with the use of estimates for swing pricing in the Proposed Rule.

In response to requests from commenters, the Final Rule provides guidance as to how a fund can determine whether securities share such substantially similar characteristics, noting that they could consider: (i) the security's liquidity trading and pricing characteristics; (ii) the security's issuance size and creditworthiness of the issuer; (iii) the number of other investors in the same security issuance; (iv) the security's maturity; or (v) the industry or geographic region applicable to the security.

The SEC continues to believe it would be reasonable to assume a market impact of zero for the fund's daily and weekly liquid assets, since a fund could reasonably expect such assets to convert to cash without a market impact to fulfill redemptions, because these assets are close to maturity. As the Final Rule requires MMFs to hold an even greater percentage of both daily and weekly liquid assets, MMFs will be required to hold a larger portion of their portfolios in securities that can be expected to have a market impact of zero.

Good Faith Estimates of Market Impacts

As part of the Final Rule, the SEC has suggested that a fund could estimate the market impact of selling a vertical slice of its portfolio using a security pricing grid. This grid would group securities in a fund's portfolio according to their financial characteristics and then estimate the price at which the securities could be sold for each group of securities under different market conditions. These grids could be developed using historical data to model the expected discount that the fund would need to take to sell a given security under a given set of market conditions.

Under this approach, a fund would develop separate grids for different market conditions (e.g., normal market conditions or conditions with interest rate stress). As market impact varies depending on the amount a fund sells, the grids would assess the market impact of selling different amounts of a security under different market conditions.
For example, on a day that a fund has net redemptions of more than 5% of net assets, the fund could calculate market impact by referring to the appropriate grid that reasonably approximates current market conditions and identifying the market impact estimate for the assumed amount to be sold.

How to Implement Pricing

As stated above, calculating the fee will require a fund to determine the fee by making a good faith estimate of the costs the fund would incur if it sold a vertical slice of each of its securities to satisfy the net redemptions. This includes: (i) spread costs; (ii) any other charges, fees, and taxes associated with the sale of those securities; and (iii) market impacts of liquidating securities (based on historical data). Once these costs have been determined,

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the fund will need to determine the liquidity fee amount as a percentage of the value of the shares redeemed to fairly allocate these costs across all redemptions.

In response to comments expressing concerns regarding the difficulty of producing timely, good faith estimates of each of these costs, a fund may apply a default liquidity fee of 1% of the value of the shares redeemed if it is unable to make such a good faith estimate of transaction costs. Finally, the Final Rule does not force a fund to impose a liquidity fee if the estimated liquidity costs are less than one basis point (0.01%) of the value of the shares redeemed (the de minimis exception). We note that the calculation of the liquidity fee, whether based on good faith estimates, the default amount, or a finding that liquidity costs are de minimis, is determined as a percentage of the value of the shares redeemed, whereas the threshold for imposing a mandatory liquidity fee is expressed as a percentage of the fund's net assets (i.e., 5% of a fund's net assets). The SEC anticipates that liquidity costs would generally remain below the de minimis amount under normal market conditions, given that MMFs already hold relatively high quality and liquid investments and that they will hold even higher levels of liquidity under the Final Rule.

Pricing Challenges and Practical Considerations for Mandatory Liquidity Fees

Although the SEC has put forth mandatory liquidity fees as easier to implement than the swing pricing proposal, there are still several operational and structural challenges inherent in implementing and calculating such a fee. To determine whether a fund has crossed the 5% daily net redemptions threshold, the fund will need to use information about net asset flows that is available within a reasonable period of time after the last pricing time of that day. Under the Final Rule, the funds must calculate net redemptions based on actual flow data for the day, and can no longer rely on estimates. These requirements raise certain practical considerations, including the following:

Determining Net Flows "Within a Reasonable Period"

In the adopting release for the Final Rule, the SEC noted that Institutional MMFs often impose order cut-off times in order to offer same-day settlement and, in the SEC's view, many Institutional MMFs should have a sizeable portion of their daily flow information by the last pricing time of the day or within a reasonable period of time thereafter. However, the SEC did acknowledge that there may be certain circumstances in which the flow information that a fund uses to determine whether it has crossed the 5% net redemption threshold does not fully reflect the fund's flows for that day (e.g., a fund receives subsequent cancellations or corrections to remedy intermediary or investor errors, which modify that day's net flows).

To address this potential misalignment, the SEC noted that to the extent a fund receives additional flow information after determining that it breached the 5% threshold but before applying the liquidity fee, the fund could take into account that additional flow information when determining the amount of the liquidity fee. Using a fund's net flows "available within a reasonable period" after the last pricing time to determine whether the 5% threshold has been crossed could result in false positives and false negatives as to the imposition of a mandatory liquidity fee. However, the SEC believes that the risks related to such false positives or negatives are relatively low because it is not anticipated that MMFs will typically impose liquidity fees under normal market conditions pursuant to the de minimis exception.

Difficulties in obtaining flow information by the last pricing time of the day may be magnified for those Institutional MMFs that are used as cash management vehicles for other funds. The SEC contemplated in the adopting

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release that these funds should consider imposing discretionary liquidity fees if they subsequently cross the 5% threshold after the last pricing time of the day under market conditions where estimated liquidity costs are not deemed to be de minimis.

Flexibility in Treatment of Individual Shareholder Redemptions

The Final Rule allows, but does not require, funds to apply a liquidity fee on an individual shareholder's net position. Accordingly, if a shareholder redeems in the morning but buys back into a MMF later during the same day that a liquidity fee is imposed, the fund may choose either to apply the liquidity fee on that individual shareholder's full, gross redemption amount or its net redemption amount for that day. MMFs should be aware of this flexibility offered by the Final Rule and should structure their applicable policies and procedures accordingly.

Availability of Gross Redemption Data From Intermediaries

Since MMFs will need to equitably allocate the liquidity fee across all redeeming investors, funds will need to have information from their intermediaries not only about net redemptions, but also about gross redemptions (and gross purchases, if opting to impose a fee on individual investors on the basis of net redemptions, as discussed below) to ensure that each investor that redeems during the imposition of a liquidity fee is allocated the liquidity fee. Intermediaries will be required to apply the liquidity fee to those shareholders in the omnibus account that have redeemed, even if the omnibus account as a whole may be net neutral or a net subscriber on a given day.

This will be challenging, as funds will need to receive gross redemption information from each intermediary for that day. As the information sharing agreements that are currently in place may not contemplate the sharing of gross redemptions every day, MMFs may be required to update their arrangements with their intermediaries in order to receive gross redemption information.

An additional challenge is that funds may not be able to receive daily gross and net flow information in a timely manner. Accordingly, the fund's guidelines for imposing mandatory liquidity fees may need to specify a cutoff time by which the fund will review its flow information for purposes of calculating the liquidity fee amount.

Furthermore, under the Final Rule, a MMF must calculate net redemptions based on actual flow data for the day as opposed to estimates. This could result in false positives and false negatives (as discussed above). This could also present obstacles for MMFs used as cash management vehicles for other funds as these MMFs could face difficulties in obtaining actual flow data by the last pricing period of the day (as discussed above).

As noted above, the Final Rule allows MMFs to apply liquidity fees based on an investor's net transaction activity for that day, provided that the MMF has adopted appropriate policies and procedures detailing its application of a liquidity on a net basis. With respect to omnibus accounts, the industry is in the process of determining how the netting of individual investor transaction activity within an omnibus account could occur in practice if, for example, both the MMF and the relevant intermediary had policies and procedures reasonably designed for doing so.

Funds With Multiple Strike Times

One of the greatest challenges facing MMFs applies to funds that have multiple strike times. These funds will have to develop a method for applying the mandatory liquidity fee to shares that were redeemed in an earlier pricing period. This poses a problem for these funds, as they may have to apply fees retroactively.

The Final Rule suggests that, to address this problem, funds could either apply the mandatory fee to the remaining balances of an investor if they did not redeem all of their shares, hold back a portion of the redeeming

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proceeds for a time while the applicable liquidity fee is being calculated, reduce the number of daily strike times, or convert the fund to only offering a single strike time daily.

Notwithstanding these solutions offered by the SEC, certain industry participants have expressed concerns about the Final Rule's impact on the continued viability of multistrike Institutional MMFs.

Pricing for Different Funds

The SEC has noted that most MMFs price at bid price, which is economically equivalent to passing spread costs to redeeming shareholders. Accordingly, funds using bid pricing will not have to include spread costs in their liquidity fee, as these funds already incorporate spread costs into their pricing. For those that do not use bid information to price their fund shares, spread costs will need to be calculated and integrated into their pricing mechanism.

Exception for Master-Feeder MMFs

The Final Rule indicates that MMFs that own shares of another MMF (i.e., a “feeder fund” that owns shares of a “master fund” pursuant to Section 12(d)(1)(E) of the 1940 Act) may not impose mandatory or discretionary liquidity fees. However, if a master fund in which the feeder invests imposes a liquidity fee, the feeder fund must pass through the liquidity fee to its redeeming investors on the same terms and conditions as imposed by the master fund. For this reason, although they are not responsible for calculating a liquidity fee, feeder funds will be subject to many of the same requirements and challenges as a master fund, such as monitoring gross redemption activity by intermediaries.

Industry Critiques of Mandatory Liquidity Fees

Despite the SEC's rationale for the Final Rule, many industry commentators have noted that the new regime continues to allow for the possibility of the imposition of a liquidity fee even if no actual transaction costs are incurred in meeting a fund's daily redemptions (e.g., if the redemption was satisfied with cash that the fund had on hand or via the scheduled maturation of portfolio securities).

As an example, MMFs are not required to impose a liquidity fee if the estimated liquidity cost of selling a vertical slice of the MMF's portfolio is less than one basis point (0.01%) of the value of the shares redeemed. As explained above, liquidity costs are calculated using a good faith estimate of the costs an Institutional MMF would incur if the fund sold a pro rata amount of each security in its portfolio to satisfy the amount of net redemptions. Thus, even in the rare circumstances where a MMF incurred no actual liquidity costs in meeting redemptions (e.g., if it met redemptions with cash on hand) but still estimated that the liquidity costs of the sale of a pro rata amount of each security in its portfolio exceeds one basis point, the MMF would be required to impose a liquidity fee. In this case, the Final Rule would impose liquidity fees on redeeming shareholders even though no actual liquidity costs were incurred by the MMF itself in order to meet redemptions.

More broadly, in the wake of the adoption of the Final Rule, the industry has noted that it has not had the opportunity to consider and comment on mandatory liquidity fees, as they were not part of the proposal. This concern was also raised by the two SEC commissioners who dissented from the adoption of the Final Rule. Further, there are concerns that the SEC failed to properly analyze and prove that dilution has actually occurred in the context of MMFs and that its economic analysis accompanying the Final Rule was not sufficient.

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DISCRETIONARY FEES

Overview

The Final Rule retains the ability of all nongovernment MMFs, including Institutional MMFs, to impose discretionary liquidity fees. As with mandatory liquidity fees, the imposition of discretionary fees is delinked from weekly liquid asset thresholds, but the Final Rule allows nongovernment MMFs to impose a discretionary liquidity fee of up to 2% if the fund's board (or its delegate) determines that a fee is in the best interest of the fund. These discretionary fees can be imposed when net redemptions are less than 5%, so long as the board (or its delegate) determines that this is in the fund's best interests. The Final Rule notes that the determination of whether to apply a discretionary fee can be irrespective of a fund's liquidity; however, a fund's board (or its delegate) generally has the latitude to consider any relevant factors when making the best interests determination, including a fund's liquidity, level of redemptions, and other factors.

Government MMFs may, but are not required to, adopt policies and procedures reasonably designed to impose discretionary liquidity fees.

In contrast to the current rule, the SEC has removed the requirement that these fees be triggered by a drop in weekly liquid assets below 30%. This was done in response to concerns that the previous rule led to unintended consequences, such as investors shifting their assets from Institutional MMFs to government MMFs that did not have the same liquidity requirements.

Calculating Discretionary Fees

The new discretionary fee will be calculated as a percentage of the redemption amount and is capped at 2% of the value of the redeemed shares. A discretionary fee will be imposed for as long as the board (or its delegate) determines that its imposition is in the best interests of the fund. The discretionary liquidity fee must be calculated on a daily basis and applied to all redemptions that are made on the day that it is imposed.

Rationale for Retaining Liquidity Fees

The SEC retained discretionary liquidity fees in response to industry feedback from several commenters who supported MMFs continuing to have the ability to impose a discretionary liquidity fee without a link to a liquidity threshold. In retaining discretionary liquidity fees, the SEC recognized that discretionary liquidity fees provide MMFs and their boards with an additional option to manage liquidity, particularly in times of market stress. The SEC posited that such discretion, especially delinked from any weekly liquid asset thresholds or required factors for implementation, should decrease the likelihood that investors could predict when a liquidity fee is going to be imposed, thus reducing the potential for a run on a MMF or other negative effects.

Furthermore, the SEC retained discretionary fees because it believes that such fees are beneficial in that many investors are less sensitive to losses than they are to losing access to liquidity. They would rather redeem and pay a liquidity fee as opposed to losing the ability to liquidate their positions immediately (i.e., in the words of the SEC, investors are more sensitive to gates than liquidity fees). The SEC hopes that removal of gates, the retention of a discretionary fee regime, and the advent of a mandatory liquidity fee, will disincentivize runs on MMFs, as shareholders will still be able to access and redeem from their MMFs, as opposed to being barred from redemptions altogether.

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BOARD RESPONSIBILITIES FOR IMPLEMENTING LIQUIDITY FEES

Board Administration and Delegation

The Final Rule imposes responsibility on a fund's board to administer both mandatory and discretionary liquidity fees (which, for mandatory fees, can be imposed at a lower level than 5% at a fund's option). However, in a change from Rule 2a-7's current requirements, the board may delegate this responsibility to the fund's adviser or officers.

In the adopting release for the Final Rule, the SEC noted that delegation of the administration of liquidity fees would be appropriate in order to allow for the timely imposition of liquidity fees, especially in periods of market stress where it may not be practical to assemble a quorum of board members in advance of the application of a liquidity fee. The SEC also noted that this delegation is suitable here because MMFs already have experience with liquidity fee requirements and such an approach is consistent with other delegable routine board functions under Rule 2a-7.

The Final Rule requires that, for a board to delegate this responsibility, it must adopt written guidelines and procedures for determining the application and size of any liquidity fees, whether mandatory or discretionary. These board-approved guidelines should detail the fund's approach to and process for determining whether the fund crossed the 5% threshold on any given day and how a fee, if imposed, will be calculated. These guidelines should also specify how the delegate will act with respect to any discretionary aspect of the liquidity fee mechanism, including, for example, whether a fund will apply a fee to a shareholder based on the shareholder's gross or net redemption activity or the fund's approach to determining the reasonable period after a day's last pricing period in which the board's delegate will measure a fund's net flows.

In addition to establishing and periodically reviewing its written guidelines related to liquidity fees, a fund's board is also required to periodically review its written guidelines and the delegate's liquidity fee determinations. As part of its initial development of these written guidelines, a fund and its board should specify what the board's periodic review will entail and how frequently such review should occur. Boards should also consider what type and level of detail they would like to receive in terms of information related to the determination and imposition of any liquidity fees, including whether such fees were effective when imposed and whether any assumptions or good faith estimates made by the board's delegate were accurate.

Recordkeeping for Liquidity Fee Calculations

As part of the Final Rule, MMFs are required to preserve records regarding their liquidity fee computations. Based on the Final Rule's publication in the Federal Register on 3 August 2023, funds are not subject to the new liquidity fee regime until 2 April 2024 (for discretionary fees) and 2 October 2024 (for mandatory fees). However, if MMFs choose to adopt either of these fee structures after 2 October 2023 but earlier than those 2024 compliance dates, they would be required to preserve records related to their fee computations. Certain fee calculation information will also be required to be reported on Form N-MFP. A fund's process for calculating liquidity fees and keeping the required records should be properly documented in its board-approved policies and procedures, as the “how” and “why” of liquidity fee calculations could be expected to be a focus of the SEC as they monitor compliance with the Final Rule.

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LIQUIDITY FEE REPORTING OBLIGATIONS AND COMPLIANCE DATES

The Final Rule includes changes to the reporting requirements for MMFs and their advisers with respect to liquidity fees.

Form N-CR

Under the Final Rule, Form N-CR will no longer require MMFs to report the application of a liquidity fee, as the SEC prefers monthly reporting of the frequency, type, and size of liquidity fees on Form N-MFP under the new regime.

Form N-MFP

The Final Rule amends Form N-MFP to require MMFs to report the date on which a liquidity fee was applied, the type of liquidity fee (i.e., mandatory or discretionary), the amount of the liquidity fee applied by the fund (both as a total dollar amount and as a percentage of the value of the shares redeemed), and, for mandatory liquidity fees, whether the amount of the liquidity fee was based on good faith estimates of liquidity costs or used the default liquidity fee of 1% of the value of shares redeemed.

Form N-1A

The Final Rule also adopts certain changes to Form N-1A. First, the Final Rule modifies the existing risk disclosure requirement in Form N-1A, which also is required under Rule 482 of the Securities Act of 1933, to reflect the revised liquidity fee framework and to remove any references to the imposition of redemption gates, which have been removed from Rule 2a-7. The Final Rule also amends required disclosures in a fund's Statement of Additional Information (SAI) that currently refer to the imposition of liquidity fees and suspension of fund redemptions, so that the new liquidity fee disclosures reflect the new liquidity fee mechanism. The revised SAI disclosures 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. This required SAI disclosure is similar to what funds will be required to report on amended Form N-MFP.

Compliance Dates

The compliance dates for the mandatory fees are 12 months from the effective date of the rule. The compliance dates for discretionary fees and related reporting obligations are six months from the effective date of the rule, but the various form requirements will be effective on 2 October 2023. Should MMFs choose to adopt mandatory or revamped discretionary fees earlier than their respective compliance dates, such MMFs would be required to meet their reporting obligations under Forms N-MFP and N-1A upon such early adoption.

WHAT THIS MEANS FOR SWING PRICING FOR NON-MMFS

While the Proposed Rule only addressed swing pricing for MMFs, the SEC followed the Proposed Rule with an additional proposal that would require, among other things, swing pricing for all open-end mutual funds with the exception of MMFs and exchange-traded funds.

While the SEC was ultimately persuaded by comments in opposition to swing pricing for MMFs because swing pricing is difficult to implement and liquidity fees provide another option for MMFs, the swing pricing proposal for non-MMFs differed in several key aspects. Primarily, swing pricing for non-MMFs would be implemented based

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on both net redemptions and net subscriptions and would explicitly require non-MMFs to impose a so-called “hard close” on purchase and redemption orders to facilitate the operation of swing pricing.

Although non-MMFs invest in different assets than MMFs and have different liquidity profiles, initial industry comments in response to swing pricing for non-MMFs also focused on the operational difficulties and obstacles non-MMFs would face in imposing swing pricing. Several commenters on the non-MMF swing pricing proposal also suggested that liquidity fees, especially discretionary liquidity fees, may be preferable to swing pricing for non-MMFs as well.

In its proposal for non-MMFs, the SEC did acknowledge that liquidity fees could be an alternative to swing pricing for non-MMFs as well, while also noting the operational difficulties with respect to implementing liquidity fees, including the burdens of obtaining daily transaction data from intermediaries in a timely manner.

If the SEC were to adopt a liquidity fee framework for non-MMFs, it is possible that such a framework would be extended to both net subscriptions and net redemptions, but it is unclear whether and how such a framework could work in practice. It remains to be seen what, and when, the SEC will adopt with respect to swing pricing for non-MMFs—but, if they listened so closely to the industry's concerns with respect to MMFs, it is possible that they could heed the same calls for non-MMFs as well.

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