



## Insights

# SEC Adopts Final Rule 2A-7 Amendments Requiring Money Market Funds to Increase Portfolio Diversification

**Regulatory Updates - SFI**  
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On July 23rd, the SEC adopted final amendments to Rule 2a-7 under the Investment Company Act of 1940. The amendments are designed to make money market funds more resilient by increasing the diversification of their portfolios. Because money market funds are significant investors in asset-backed securities (ABS), these portfolio diversification requirements will impact the securitization market.

Prior to today's amendments, Rule 2a-7 generally required money market funds to limit their investments in: (i) the securities of any one issuer of a first tier security (other than with respect to government securities and securities subject to a guarantee issued by a non-controlled person) to no more than 5% of fund assets; and (ii) securities subject to a demand feature or a guarantee to no more than 10% of fund assets from any one provider.

The final amendments, which were adopted largely as initially proposed by the SEC on June 5, 2013, include two new rules that will impact asset-backed securities (ABS):

### **1. Affiliate Aggregation Rule:**

When calculating the amount of their total assets invested in securities issued by any particular issuer for purposes of Rule 2a-7's issuer diversification requirements, money market funds will be required to treat as a single issuer two or more issuers of securities owned by a fund if one issuer controls the other issuer, is controlled by the other issuer, or is under common control with the other issuer. This amendment is referred to as the "affiliate aggregation rule."

The affiliate aggregation rule will apply to determine what entities are 10% obligors (and, therefore, issuers) for purposes of Rule 2a-7.

In adopting the final rule, the SEC responded to industry comments to the proposed amendments by including an exception to the affiliate aggregation rule for certain majority equity owners of asset-backed commercial paper (ABCP) conduits. Specifically, money market funds need not aggregate an ABCP conduit and its independent equity owners for purposes of the 5% issuer diversification limit provided that (x) a primary line of business of those independent equity owners is owning equity interests in special purpose entities, (y) the independent equity owners' activities with respect to the special purpose entity are limited to providing management or administrative services and (z) no qualifying assets of the ABCP conduit were originated by the equity owners.

## **2. ABS Sponsor Rule:**

A money market fund will be required to treat sponsors of ABS as guarantors subject to Rule 2a-7's 10% diversification limit applicable to guarantees and demand features unless the board of directors of the investing money market fund makes a determination that the fund did not rely on the sponsor's financial strength for credit or liquidity purposes. In other words, regardless of whether the sponsor has committed to provide explicit credit or liquidity support, the ABS sponsor rule would generally require a money market fund to deem the sponsor as having provided a guarantee of the entire principal amount of the ABS. This amendment is referred to as the "ABS sponsor rule."

The SEC also separately issued proposed revisions to Rule 2a-7 that would provide that issuers that are subject to guarantees by "non-controlled persons" would be subject to the issuer diversification requirements of the Rule. If adopted this would mean that fully-supported ABCP conduits that are currently subject only to the guarantor diversification requirements of Rule 2a-7 will also be subject to the issuer diversification requirements.

Also, the ABS sponsor rule will apply in determining what entities are guarantors of 10% obligors for purposes of Rule 2a-7.

The effective date for today's amendments will be 60 days after publication of the final amendments in the Federal Register. The compliance date for the aspects of the Rule 2a-7 amendments described above will be 18 months after the effective date of the amendments.

For a copy of the final rule, please [click here](#).

For a copy of the proposed revisions to Rule 2a-7, please [click here](#).