

Legal Update

US Federal Reserve and SEC Provide Further Relief and Guidance to Money Market Funds Affected by COVID-19 Market Developments

The Board of Governors of the Federal Reserve System ("Federal Reserve") has taken additional measures following the launch of the Money Market Mutual Fund Liquidity Facility ("MMLF") to address continuing liquidity concerns for securities held by money market mutual funds ("MMFs") resulting from market conditions related to the recent COVID-19 outbreak. For background on the MMLF and its establishment, please see our COVID-19 Response Blog post available [here](#).

The Federal Reserve continues to implement an expansive and comprehensive COVID-19 relief program. The Federal Reserve has also published guidance related to the MMLF to aid MMFs and related market participants, and more guidance is expected in the coming days. Similarly, the US Securities and Exchange Commission ("SEC") has provided relief to MMFs and their affiliates to address ongoing liquidity issues due to COVID-19. Early reports indicate that market participants have shown interest in measures by the Federal Reserve and the SEC to support MMFs and the US economy as a whole.

Federal Reserve Expands COVID-19 Relief Program

The Federal Reserve decided on March 23, 2020 to expand its credit relief program to combat market disruptions resulting from COVID-19.¹ The enhancements to the Federal Reserve's relief program include:

- The Federal Open Market Committee ("FOMC") will purchase Treasury securities and agency mortgage-backed securities in the amounts needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy. The FOMC had previously announced it would purchase at least \$500 billion of Treasury securities and at least \$200 billion of mortgage-backed securities. In addition, the FOMC will include purchases of agency commercial mortgage-backed securities in its agency mortgage-backed security purchases.
- Support to the flow of credit to employers, consumers, and businesses through the establishment of new programs that, taken together, will provide up to \$300 billion in new financing. The Department of the

Treasury, using the Exchange Stabilization Fund, will provide \$30 billion in equity to these facilities.

- Establishment of two facilities to support credit to large employers – the Primary Market Corporate Credit Facility for new bond and loan issuance and the Secondary Market Corporate Credit Facility to provide liquidity for outstanding corporate bonds.
- Establishment of a third facility, the Term Asset-Backed Securities Loan Facility (“TALF”), to support the flow of credit to consumers and businesses. The TALF will enable the issuance of asset-backed securities backed by student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration, and certain other assets.
- Facilitation of credit to municipalities by expanding the MMLF to include a wider range of securities, including municipal variable rate demand notes and bank certificates of deposit, and the Commercial Paper Funding Facility (“CPFF”) to include high-quality, tax-exempt commercial paper as eligible securities. (In addition, the pricing of the CPFF has been reduced.)²

Hopefully these measures, in tandem with the Federal Reserve’s previous efforts, will sustain a healthy flow of credit to households and businesses and promote the Federal Reserve’s Congressional mandate to promote maximum employment and stable prices.

Federal Reserve Publishes MMLF Guidance and Form Documents

On March 21, 2020, the Federal Reserve published MMLF FAQs about the program.³ The MMLF FAQs highlight the basics of the MMLF, including the purpose and design of the MMLF, information about eligible borrowers, collateral requirements, accounting and regulatory implications, process and procedure, and various ancillary matters. The

FAQs are part of an ongoing response that the Federal Reserve has been continually revising as it considers additional measures to address liquidity concerns. Since our last [MMLF COVID-19 Response Blog post](#), the Federal Reserve has updated the list of securities that are eligible collateral for pledge under the MMLF. The list currently includes:

- US Treasuries and fully guaranteed agency securities;
- Securities issued by US government-sponsored entities;
- Asset-backed commercial paper, unsecured commercial paper or a negotiable certificate of deposit that is issued by a US issuer, is rated at the time purchased from the MMF or pledged to the Federal Reserve Bank of Boston (“FRBB”) not lower than A1, F1, or P1 by at least two major nationally recognized statistical rating organizations (“NRSROs”) or, if rated by only one NRSRO, is rated within the top rating category by that NRSRO;
- US municipal short-term debt (excluding variable rate demand notes) that has a maturity not exceeding 12 months, and at the time of purchase or pledge to the FRBB: (i) is rated in the top short-term rating category (e.g., rated SP1, MIG1, or F1, as applicable) by at least two major NRSROs or if rated by only one major NRSRO, is rated within the top rating category by that NRSRO; or (ii) if not rated in a short-term rating category, is rated in one of the top two long-term rating categories (e.g., AA or equivalent, or above) by at least two major NRSROs or if rated by only one major NRSRO, is rated within the top two rating categories by that NRSRO;
- Variable rate demand notes with a demand feature allowing holders to tender the note at their option within 12 months, and at the time purchased or pledged to the FRBB: (i) is rated in the top short-term rating category (e.g., rated SP1, VMIG1, or F1, as applicable) by at least two major NRSROs or

if rated by only one major NRSRO, is rated within the top rating category by that NRSRO; or (ii) if not rated in a short-term rating category, is rated in one of the top two long-term rating categories (*e.g.*, AA or equivalent, or above) by at least two major NRSROs or if rated by only one major NRSRO, is rated within the top two rating categories by that NRSRO; and

- Receivables from certain repurchase agreements.⁴

The FRBB has also published form documents, which include certain agreements, reporting items, notices and borrowing documentation in order to facilitate the implementation of the MMLF.⁵ These forms are available on the Federal Reserve's Discount Window website for firms to use in connection with their participation in the MMLF.⁶

SEC Provides Temporary Relief for Affiliated MMF Asset Purchases

On March 19, 2020, staff of the SEC's Division of Investment Management provided temporary no-action relief to firms seeking to engage in affiliated MMF asset purchases in response to current short-term dislocations and liquidity problems in the market for securities held by MMFs.⁷ Rule 17a-9 under the Investment Company Act of 1940 (the "1940 Act") provides a conditional exemption from Section 17(a) of the 1940 Act's prohibition on certain affiliated principal transactions.⁸ Rule 17a-9 permits any affiliated person, promoter, principal underwriter of an MMF or any affiliated person of such person to purchase securities from the MMF upon meeting certain conditions.⁹

Some purchasers of securities that otherwise would be permitted to engage in these transactions in reliance on Rule 17a-9 have questioned their ability to do so in light of certain conflicting banking regulations to which the potential purchasers are subject,

e.g., Section 23A and 23B of the Federal Reserve Act and Regulation W.¹⁰ The staff's no-action position is subject to the following conditions:

- the purchase price of the security would be its fair market value as determined by a reliable third-party pricing service (as opposed to the greater of amortized cost or market value as required by the rule);
- any affiliated purchases satisfy the conditions of 1940 Act Rule 17a-9, except to the extent that the terms of such purchases would otherwise conflict with (i) applicable banking regulations; or (ii) the exemption issued by the Federal Reserve on March 17, 2020, defining "covered transaction" for purposes of Section 23A of the Federal Reserve Act not to include the purchase of assets from an affiliated MMF;
- the MMF timely files Form N-CR reporting such transaction under Part C, and reports in Part H that the purchase was conducted in reliance on the staff's no-action letter; and
- the relief is available only on a temporary basis in response to the COVID-19 outbreak and will cease to be in effect upon notice from SEC staff.

Market Reactions to Liquidity Relief Measures

Measures taken by the Federal Reserve and the SEC have been heralded as a welcome reprieve for MMF sponsors, some of whom, including major banking institutions, have rapidly adopted liquidity programs to support their affiliated MMFs. Two US global systemically important banks have already purchased more than \$3 billion in assets from affiliated MMFs.¹¹ We expect that others will follow suit if liquidity issues related to COVID-19 persist, and we expect further regulatory response to the liquidity issues related to COVID-19, which we will be closely monitoring.

This action is part of an evolving COVID-19 response that is moving across regulatory agencies. Please visit [our website](#) to learn more.

If you have any questions about the developments discussed above, or about Federal Reserve or SEC responses to COVID-19 more generally, please contact Stephanie Monaco, Brad Keck, Carol Hitselberger, Jeff Taft, Marlon Paz, Leslie Cruz, Kyle Swan, or Matt Bisanz. We will continue to keep our clients updated on future significant regulatory developments related to COVID-19.

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Endnotes

¹ Federal Reserve announces extensive new measures to support the economy (Mar. 23, 2020), <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm>

² See Federal Reserve Launches Commercial Paper Funding Facility (Mar. 24, 2020), <https://covid19.mayerbrown.com/government-federal-reserve-launches-commercial-paper-funding-facility/>

³ Money Market Mutual Fund Liquidity Facility FAQs (Mar. 21, 2020), <https://www.federalreserve.gov/monetarypolicy/files/mmlf-faqs.pdf>

⁴ This list is subject to change as the Federal Reserve considers the feasibility of adding other asset classes.

⁵ Key Information on the Money Market Mutual Fund Liquidity Facility (MMLF) (Mar. 21, 2020), <https://www.bostonfed.org/news-and-events/news/2020/03/key-information-money-market-mutual-fund-liquidity-facility.aspx>

⁶ Federal Reserve, *Other Agreements & Documents* (retrieved Mar. 24, 2020), <https://www.frbdiscountwindow.org/pages/agreements/other-agreements-documents>

⁷ SEC No-Action Letter, Investment Company Institute (Mar. 19, 2020), <https://www.sec.gov/investment/investment-company-institute-031920-17a>

⁸ 15 U.S.C. § 80a-17(a); 17 C.F.R. § 270.17a-9.

⁹ 17 C.F.R. § 270.17a-9.

¹⁰ 12 U.S.C. § 371c; 12 U.S.C. § 371c-1; 12 C.F.R. Part 223.

¹¹ See Tim McLaughlin, *Exclusive: Goldman injects \$1 billion into own money-market funds after heavy withdrawals*, REUTERS (Mar. 21, 2020), <https://www.reuters.com/article/us-health-coronavirus-goldman-mny-mkt-ex/exclusive-goldman-injects-1-billion-into-own-money-market-funds-after-heavy-withdrawals-idUSKBN21810A>

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