

Regulatory Notice

08-60

Money Market Mutual Funds

FINRA Announces Temporary Margin Maintenance, Net Capital and Reserve Formula Requirements Related to Money Market Mutual Funds

Effective Date: October 21, 2008

Executive Summary

The purpose of this *Notice* is to advise FINRA firms that pursuant to NASD Rule 2520(f)(8)(A), NYSE Rule 431(f)(8)(A) and SEA Rules 15c3-1 and 15c3-3, FINRA is announcing temporary margin maintenance, net capital and reserve formula requirements related to certain money market mutual funds that have frozen customer redemptions or whose net asset value has declined below \$1.00 per share, effective October 21, 2008.

Questions concerning margin as described in this *Notice* should be directed to:

- Rudolph Verra, Managing Director, Risk Oversight and Operational Regulation, at (646) 315-8811;
- Glen Garofalo, Director, Credit Regulation, at (646) 315-8464; or
- Steve Yannolo, Principal Credit Specialist, Credit Regulation, at (646) 315-8621.

Questions concerning net capital and reserve formula as described in this *Notice* should be directed to:

- Yui Chan, Managing Director, Risk Oversight and Operational Regulation, at (646) 315-8426;
- Bernadette Chichetti, Director, Risk Oversight and Operational Regulation, at (646) 315-8428; or
- Anthony Lucarelli, Director, Risk Oversight and Operational Regulation, at (646) 315-8520.

October 2008

Notice Type

- Special Alert

Suggested Routing

- Compliance
- Finance
- Legal
- Margin Department
- Operations
- Regulatory Reporting
- Senior Management

Key Topic(s)

- Customer Protection
- Initial Margin Requirements
- Maintenance Margin Requirements
- Money Market Mutual Funds
- Net Capital

Referenced Rules & Notices

- NASD Rule 2520
- NYSE Rule 431
- Regulation T §§ 220.2
- SEA Rule 15c3-1
- SEA Rule 15c3-3



Financial Industry Regulatory Authority

Background & Discussion

Money market mutual funds (MMMF) usually maintain a net asset value (NAV) of \$1.00 per share but due to current problems in the credit markets, the NAV of certain funds has declined below \$1.00 per share. Several funds have received a significant number of requests for withdrawals, which have caused fund managers to liquidate assets held within the fund at distressed market prices. In an attempt to prevent further price deterioration, and potential losses, certain MMMF's have temporarily suspended redemptions of fund shares. Consequently, holders of such MMMFs may not have access to their funds in order to purchase securities or meet other obligations.

As a result of the foregoing, several firms have elected to provide their customers with liquidity on their MMMF holdings, despite the funds' suspension of redemptions. Typically, this liquidity has taken two forms:

- Firms have permitted customers to purchase securities based on the value of the MMMF held in their account.
- Firms have agreed to advance the customers the value of the MMMF that the customer attempted to redeem but couldn't due to the suspension of redemptions by the fund. In these instances, firms have advanced the cash to their customers without having received payment from the MMMFs; this practice has a similar effect on the firm as that of an outright purchase of the MMMF from the customer.

Although most customers maintain their MMMF in a cash account, the shares may also be held in a margin account and may be used as collateral for a margin loan. A MMMF is margin eligible provided it meets the definition of a margin security under Regulation T 220.2. The current initial and maintenance margin requirement promulgated under NASD Rule 2520 and NYSE Rule 431 is 1 percent of the market value or NAV.

FINRA has received questions from firms regarding the net capital and customer reserve formula treatment of certain customer account balances resulting from the actions taken by such firms to provide their customers with liquidity on MMMFs that have suspended redemptions. In consultation with the staff of the SEC, FINRA is providing the following guidance:

1. In instances where the MMMF cannot presently be liquidated, firms may have elected to record entries which reflect the firm purchasing the MMMF from the customers, which would result in a proprietary long position for the firm and a credit to the customer account for the proceeds of the MMMF shares sold to the firm. In computing its net capital pursuant to SEA Rule 15c3-1, the firm must mark to the market the MMMF position and apply a 15 percent haircut on the total market value held in its proprietary account. The foregoing net capital treatment of the MMMF is not limited to positions that firms purchase from their customers but also applies to all proprietary positions held in such funds. In computing its customer reserve formula pursuant to SEA Rule 15c3-3, the firm must include in its computation any remaining balance in the customer's account following the sale of the MMMFs to the firm.
2. In instances where the MMMF cannot presently be liquidated, firms may have elected to record entries that reflect the redemption of the customers' MMMF, which would result in a receivable from the MMMF and a payable to the customers. For net capital purposes, the firm may treat the receivable from the MMMF as an allowable asset only up to the aggregate of related customer credits that remain in the customers' accounts. However, if the amounts credited to the customers' accounts are withdrawn by the customers or if the credited amounts are used to reduce a debit balance in the customers' accounts, the aggregate amount of such items, relative to the firm's receivable from the MMMF, is to be treated by the firm as if it were a proprietary long position in the MMMF. In computing its net capital, the firm must mark to the market the MMMF and apply a 15 percent haircut. Any credits remaining in the customer accounts must be included in the reserve formula computation. Only the amount of the receivable from the MMMF that equates to the corresponding credits remaining in the customer accounts must be included as a debit in the reserve formula computation.

3. In instances where the MMMF cannot be liquidated, the position remains in the customer's account, and the customer requests to utilize the MMMF position in his or her account as payment for the purchase of securities, the firm may consider up to 50 percent of the NAV of the MMMF as payment for a new security purchase. This treatment will apply whether the purchase is executed in a cash account or a strategy-based margin account. If the amount due from the purchase exceeds 50 percent of the NAV of the MMMF, the firm must treat the overage amount as an outstanding cash debit or Regulation T call. Therefore, the customer will be required to deposit cash or margin eligible securities to satisfy the outstanding amount due within five business days after the trade date of the purchase. The remaining debit balance can be included in the reserve formula computation. If the customer does not satisfy the amount due within five business days after trade date, the firm will be required to take appropriate action, which may include filing for an extension of time, where applicable. Furthermore, the regulatory maintenance margin requirement on a MMMF that has frozen customer redemptions or whose NAV has declined below \$1.00 per share, that are held in a strategy-based margin account, shall be 50 percent of the current NAV of such MMMF.
4. Several firms have elected to mitigate client losses on their MMMF positions. Those firms must accrue the total amount of their liability to the customer and reflect the expense in their current profit and loss statement. If the firm has not limited the amount of loss it will cover, then it must treat the customer's entire position as a proprietary contractual commitment, mark it to market and apply a 15 percent haircut in computing its net capital.