Generally, Parts 17 and 18 of the regulations require reports from members of contract markets, FCMs or foreign brokers and traders respectively when a trader holds a "reportable position," i.e., the open position held or controlled by the trader at the close of business in any one future of a commodity traded on any one contract market equal or exceed the quantities fixed by the Commission in § 15.03(a) of the regulations. See Rule 15.00(b), 17 CFR 15.00(b) (1982).

Members of contract markets, FCMs and foreign brokers who carry accounts in which there are "reportable positions" of traders are required to identify such accounts on a Form 102 and report on the series '01 forms any reportable positions in the account, the delivery notices issued or stopped by the account and any exchanges of futures for physicals. Traders who own or control reportable positions are required to file annually a CFTC Form 40 giving certain background concerning their trading in commodity futures and, on call by the Commission, must submit a Form 103 showing positions and transactions in the commodity specified in the call.

The Commission has determined that the growth in trading volume, open interest, and position sizes of individual traders in certain markets enables the Commission to maintain effective surveillance of those markets with fewer reports from members of contract markets, FCMs foreign brokers and the trading public.[2] Accordingly, as part of its ongoing efforts to reduce reporting burdens, where possible, the Commission has determined that reporting levels should be raised for the following commodities: in gold from 100 contracts to 200 contracts; in sugar and GNMAs from 50 contracts to 100 contracts; in long-term U.S. Treasury notes, 90-day Treasury bills, Domestic Certificates of Deposit, Eurodollars and Heating Oil from 25 contracts to 50 contracts; in Long-term Treasury bonds from 50 contracts to 150 contracts; and in Foreign Currencies and certain Stock Index futures from 25 contracts to 100 contracts.[3]

grains (including oats, barley and flaxseed), corn, soybeans, rye, eggs, cotton, and potatoes. 17 CFR Part 150 (1982).

[2] In one commodity, silver, however, the Commission has determined that more reports may be necessary. In a separate Federal Register release, the Commission is proposing that reporting levels in silver be reduced.

[3] The Commission finds that its action to raise reporting levels in the above commodities relieves an existing burden and that the notice and other public procedures called for by 5 U.S.C. 553 are not required, 5 U.S.C. 553(b) (1976). The Commission, therefore, is adopting the amendments to Rule 15.03(a) effective July 15, 1983.

The Regulatory Flexibility Act

As the Commission has not published a prior general notice of proposed rulemaking with respect to these amendments which are relief measures, the amendments are not "rules" as that term is defined in Section 3(a) of the Regulatory Flexibility Act ("RFA"), Pub. L. 96-354, 94 Stat. 1165 (5 U.S.C. 601(2)).[4]

Paperwork Reduction Act

The Paperwork Reduction Act of 1980, Pub. L. 96-511, 94 Stat. 2812 *et seq.* ("PRA"), imposes certain requirements on federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information as defined by PRA. 44 U.S.C. 3501 *et seq.* OMB control number 3038-0009 has previously been assigned to those regulations within Parts 15, 17, and 18 which impose collection of information and recordkeeping requirements.[5]

List of Subjects in 17 CFR Part 15

Brokers, Commodity futures, Reporting and recordkeeping requirements.

In the consideration of the foregoing and pursuant to its authority under Sections 4g, 4i, 5(b) and 8a(5) of the Commodity Exchange Act, 7 U.S.C. Sections 6(g), 6(i), 7(b) and 12a(5) as amended by the Futures Trading Act of 1982, Pub. L. 97-444, 96 Stat. 2294 (1983), the Commission is amending Part 15 of Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 15—REPORTS—GENERAL PROVISIONS

1. Section 15.03 is amended by revising paragraph (a) as follows:

§ 15.03 Quantities fixed for reporting.

(a) The quantities for the purpose of reports filed under Parts 17 and 18 of this chapter are as follows:

Commodity	
Wheat (bushels)	500,000
Corn (bushels)	500,000
Soybeans (bushels)	500,000
Oats (bushels)	200,000
Rye (bushels)	200,000
Barley (bushels)	200,000
Flaxseed (bushels)	200,000
Soybean Oil (contracts)	100
Soybean Meal (contracts)	100
Live Cattle (contracts)	100
Hogs (contracts)	50
Cotton (bales)	5,000
Sugar (contracts)	100
Copper (contracts)	100
Gold (contracts)	200
Silver Bullion (contracts)	250
Silver Coins (contracts)	50
#2 Heating Oil (contracts)	50
Long-term U.S. Treasury Bonds (contracts)	150
GNMA (contracts)	100
Three-month (13-week) U.S. Treasury Bills (contracts)	50
Long-term U.S. Treasury Notes (contracts)	50
Domestic Certificates of Deposit (contracts)	50
Three-month Eurodollar Time Deposit Rates (contracts)	50
Foreign Currencies (contracts)	100
Standard and Poor's 500 Stock Price Index (contracts)	100
New York Stock Exchange Composite Index (contracts)	100
All Other Commodities (contracts)	25

[4] That section defines the term "rules" as "any rule for which the agency publishes a general notice of proposed rulemaking pursuant to Section 553(b) of this title. . ."

[5] See 44 U.S.C. 3502(4) (Supl V. 1981) defining the term "collection of information."

* * * * *

The foregoing amendments to Part 15 to raise reporting levels in certain commodities are adopted effective July 15, 1983. The Commission finds that the foregoing action relieves a burden heretofore imposed and therefore, that the notice and other public procedures called for by 5 U.S.C. 553 are not required.

Issued in Washington, D.C., on July 12, 1983, by the Commission.

Jane K. Stuckey,

Secretary of the Commission.

[FR Doc. 83-19345 Filed 7-15-83; 8:45 am]

BILLING CODE 6351-01-M

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release No. IC-13380, File No. S7-920]

Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds)

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting a rule regarding the valuation of debt instruments, the calculation of current net asset value per share and the computation of current price per share by certain registered open-end investment companies, commonly referred to as "money market funds." The rule premits such investment companies, subject to enumerated conditions, either: (1) To value portfolio securities by use of the amortized cost valuation method; or (2) to compute current price per share by rounding the net asset value per share to the nearest one cent, based on a share

value of one dollar. Previously, the Commission granted individual orders of exemption to permit use of those valuation or pricing methods. The rule obviates the need for most, if not all, of such applications.

EFFECTIVE DATE: July 18, 1983.

FOR FURTHER INFORMATION CONTACT: H. R. Hallock, Jr., Special Counsel (202-272-3030), or Gene A. Gohlke, Chief Financial Analyst (202-272-2024), Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission is adopting rule 2a-7 [17 CFR 270.2a-7] under the Investment Company Act of 1940 ("Act") [15 U.S.C. 80a-1 *et seq.*] to permit, subject to specified conditions, certain open-end investment companies, known as "money market funds," to compute their current price per share for purposes of distribution, redemption and repurchase by using either: (1) The "amortized cost" method of valuation to value their portfolio instruments for purposes of calculating their current net asset value per share; or (2) the "penny-rounding" method of computing their current price per share.

Under the amortized cost method of valuation, money market funds may calculate their current net asset value for use in computing the current price of their redeemable securities by valuing all portfolio securities and assets, regardless of whether market quotations are readily available, at the acquisition cost as adjusted for amortization of premium or accretion of discount rather than at current market value as would be required by rule 2a-4 under the Act. [17 CFR 270.2a-4].

Under the penny-rounding method of computation, money market funds calculate their current net asset value in conformance with rule 2a-4 by valuing portfolio securities for which market quotations are readily available at current market value, and other securities and assets at fair value as determined in good faith by the board of directors. However, they may then compute the current price of their redeemable securities by rounding the net asset value per share to the nearest one cent on a share value of one dollar.

Rule 2a-7 provides that in order to use either of the above valuation or pricing methods a money market fund must comply with certain conditions. Those conditions basically: (1) Limit the types of investments that the money market fund can make to short-term, high quality debt instruments; (2) impose on the board of directors (trustees in the case of a trust; hereinafter referred to as "board of directors" or "board") of the money market fund a special obligation to ensure that a stable price per share is maintained; and (3) require that the board of directors of the money market fund, in good faith, determine that it is in the best interests of the fund and its shareholders to maintain a stable net asset value or price per share and that the money market fund will discontinue its use of either method if such method ceases to reflect fairly the market-based net asset value per share. In addition, a money market fund using the amortized cost method of valuation must monitor the deviation between the price of its shares computed from a net asset value per share calculated using amortized cost values for its portfolio instruments and the net asset value of such shares calculated using values for portfolio instruments based upon current market factors. If such deviation exceeds ½ of one percent of the price per share or if the amount of deviation may result in material dilution or other unfair results to shareholders, the rule imposes specific obligations on the board of directors to respond to the situation. Likewise, a money market fund using the penny-rounding method to compute its price per share may have to monitor in a similar fashion the valuation of those portfolio instruments with remaining maturities of sixty days or less [1] that are valued at amortized cost in order to assess the fairness of that valuation method.

The reasons for proposing rule 2a-7 and the administrative history of the rule are discussed thoroughly in Investment Company Act Release No. 12206 (February 1, 1982) ("Release 12206"), 47 FR 5428 (February 5, 1982). In brief, the rule generally codifies the standards that were developed for granting the applications filed by money market funds for exemption from the pricing and valuation provisions of the Act, with a slight expansion of the types of instruments permitted for purchase. Persons interested in a more detailed discussion of the genesis of the rule should refer to that release.

Rule 2a-7 is designed to obviate the need for individual money market funds to file applications for exemptive orders to permit the use of either penny-rounding or amortized cost methods. In addition, the Commission recognizes that money market funds with existing exemptive orders may wish to rely on the rule rather than their individual orders. The Commission has no objection to money market funds ceasing to rely on their individual exemptive orders and using instead rule 2a-7 as the basis for their pricing or valuation method, provided that the board of directors of any such money market fund approves the change and the fund makes any necessary disclosure to shareholders. In addition, rule 2a-7 is designed to clarify the obligations of money market funds and their boards of directors when using either the amortized cost or penny-rounding method. As stated in the release proposing rule 2a-7, the rule is not intended to expand the responsibilities and liabilities imposed upon directors beyond those imposed under the exemptive orders. Guidance provided by this release should be considered generally applicable to a money market fund operating pursuant to an exemptive order or pursuant to rule 2a-7.

In response to its requests for comments, the Commission received 21 letters. The commentators universally agreed that proposed rule 2a-7 should be adopted, with certain amendments. A number of commentators, however, expressed strong objections to some of the positions taken by the Commission in Release 12206. Those objections and the Commission's response are discussed in detail below. As a result of its consideration of the comments, the Commission has determined to adopt rule 2a-7, subject to several modifications of the proposal, and to issue this release, which will serve, rather than Release 12206, as the operative interpretive vehicle.

Discussion

Under rule 2a-7, investment companies that have investment portfolios consisting entirely of U.S. dollar-denominated short-term debt obligations ("money market funds") [2]

[1] *See* footnote 44, *infra*.

[2] The Commission received a comment that the rule should be amended to include this definition of a money market fund. The description has not been added as a definition under the rule because it is not an exclusive definition of a money market fund. The rule permits only an investment company that has the requisite portfolio (*e.g.*, entirely U.S. dollar-denominated short-term debt obligations) to reply upon it; provided that all the conditions of the rule are satisfied. The Division of Investment Management has recently taken the position that it would not object if a money market fund utilizing an amortized cost exemptive order invests, within certain limitations, in shares or units of other investment companies which invest primarily in high quality, short-term municipal instruments and which determine their net asset value based on the amortized cost or penny-rounding methods in reliance on Commission exemptive orders or proposed rule 2a-7 under the Act when it is adopted. *See* letter from Gerald Osheroff, Associate Director, Division of Investment Management to John J. Scott, Esquire, on behalf of The Benchmark Tax-Exempt Fund, dated June 28, 1983.

may use either the penny-rounding pricing method or the amortized cost valuation method for purposes of computing their price per share on their net asset value per share, respectively, provided that they comply with the conditions enumerated in the rule. Those conditions are designed to ensure that any money market fund that adopts one of the above procedures in an effort to maintain a stable price per share will be able to maintain that stable price.

The conditions contained in the rule, as well as those conditions found in individual exemptive orders, provide for a special system of safeguards to protect the fund. The responsibility for designing and effectuating that system is placed on the board of directors. As a part of that system of safeguards, the directors have undertaken the specific responsibility of monitoring the market value of the portfolio, in the case of funds using amortized cost valuation, and have represented that the fund will limit investments to those instruments which the board deems to meet certain criteria. Some commentators opined that such responsibilities should be placed on the investment adviser rather than the board of directors. While the Commission realizes that, as a practical matter, board of directors may lack technical expertise and must rely on the investment adviser to provide factual information and advice, it believes that the final responsibility for the fund's operations should remain with the board of directors. The Commission bases its determination on the fact that the board is traditionally the fund's ultimate authority, as well as the possibility of inherent conflicts between the interests of the investment adviser and those of the funds. Accordingly, the rule as adopted continues to place ultimate responsibility for fulfilling the conditions of the exemptive relief on the board of directors.

In stating that certain functions are the responsibility of the board of directors, the rule does not require that the board personally become involved in the day-to-day operations of the fund, nor does the rule require the board to be an insurer of the fund or the fund's investment adviser. The Commission sought in Release 12206 to clarify, through examples, that the board could delegate certain day-to-day functions to the investment adviser and still be in compliance with the rule. However, comments received in response to the rule proposal indicated apparent confusion by some parties who were concerned that the rule would require the board personally to carry out the day-to-day operations of the fund. The Commission recognizes that such a requirement would be inefficient and unrealistic. Therefore, in an effort to clarify its position, the Commission has modified somewhat the language of the rule, as discussed hereinafter.

The rule, like the prior exemptive orders, specifically states that the board shall be responsible for certain functions, such as monitoring the value of the portfolio and determining the quality of its instruments. While the board retains the final responsibility for the operations of the fund and the specific procedures required by the rule, the rule does not preclude the board from delegating duties and functions (to be carried out under its supervision) to the investment adviser. This release set forth in detail some methods by which the board may delegate certain responsibilities and still be deemed to be in compliance with the rule. These examples are not intended to be the exclusive method of compliance. However, they are meant to set forth the Commission's view that a delegation will not be deemed satisfactory where the board's only participation is an approval after the fact. The Commission believes that, at a minimum, the board should have knowledge in advance of how the functions will be performed by the investment adviser; the board should assure itself that such methods are reasonable and provide any guidance necessary; and finally, the board should review periodically the investment adviser's performance.

The rule also provides, under both methods, for the computation of a share price that will represent fairly the current net asset value per share of the investment company, thus reducing any possibility of dilution of shareholders' interests or other unfair results.[3]

Rule 2a-7 provides that money market funds satisfying the necessary conditions may use either the penny-rounding or amortized cost method. In Release 12206 the Commission stated that while a fund which had elected one of the methods was not foreclosed from switching to another method,[4] the rule would not permit a fund to use both methods at the same time, i.e., the amortized cost valuation method to calculate its net asset value per share and rounding of that net asset value to the nearest one cent of a dollar when computing its price per share.[5]

The Commission received a substantial number of comments expressing the view that money market funds using the amortized cost valuation method should be permitted to penny-round when computing their price per share. These commentators argued that without the ability to penny-round, funds using the amortized cost valuation method would be disadvantaged, and that the ½ of 1 percent limitation on the deviation of the price away from the market-based net asset value per share would limit the amount of rounding to the equivalent of that used by funds under the penny-rounding method. After considering these comments, the Commission has determined that it is appropriate to permit funds using the amortized cost valuation method to round to the extent permitted to funds opting to use the penny-rounding method, i.e., the deviation between the price per share and the market based net asset value per share may not exceed ½ of 1 percent.

While the Commission is proposing to permit a fund using the amortized cost valuation method to round its net asset value per share beyond the extent considered material as set forth in Investment Company Act Release No. 9786 (May 31, 1977) ("Release 9786"), 42 FR 28999 (June 7, 1977)[6] in computing its price per share, it emphasizes the responsibilities of the board when such a method is used. A basic premise justifying the use of the amortized cost valuation method is the fact that securities held until maturity will eventually yield a value equivalent to the amortized cost value, regardless of the current disparity between amortized cost value and market value. Thus, the Commission is willing to permit funds to use amortized cost valuation so long as the disparity between the amortized cost value and current market value remains minimal. Funds using the amortized cost valuation method may need to use penny-rounding in computing their price per share when a gain or a loss in the value of their portfolio, which was not offset against earnings, is recognized. Where the gain or loss has been recognized, there is no longer merely a potential for a deviation between the value assigned by the fund for the securities sold and that actually realized by the fund. The Commission does not wish to define the premissible

[3] If shares are sold based on a net asset value which turns out to be either understated or overstated in comparison to the amount at which portfolio investments could have been sold, then either the interests or existing shareholders or new investors will have been diluted.

[4] Prior to any such switch, the board of directors should approve such action and any necessary disclosure should be made to shareholders.

[5] *See* footnote 5 of Release 12206.

[6] Release 9786 sets the amount of less than 1/10 of one cent on a share value of one dollar as the benchmark for materiality.

amount of deviation. However, to the extent a fund has realized gains or losses that cause the fund's price per share to deviate from the amortized cost net asset value per share, the board must be particularly careful to ensure that the fund can maintain a stable price per share. The fact that a fund may penny-round while utilizing amortized-cost valuation does not, of course, diminish the board's responsibility to monitor the market-based net asset value, nor does it increase the permissible deviation between share price and market-based asset value.

Permissible Portfolio Investments

The rule, like the previously granted exemptive orders, is designed to limit the permissible portfolio investments of a money market fund seeking to use either penny-rounding or the amortized cost valuation method to maintain a stable price per share to those instruments that have a low level of volatility [7] and thus will provide a greater assurance that the money market fund will continue to be able to maintain a stable price per share that fairly reflects the current net asset value per share of the fund. Accordingly, money market funds relying on the rule may purchase only those portfolio instruments which meet the quality and maturity requirements of the rule.[8] The rule, however, would not prohibit a money market fund from holding cash reserves. It should be noted that the rule does not speak to the acquisition or valuation of puts or stand-by commitments by a money market fund wishing to use the subject valuation or pricing methods.[9] The Commission has granted exemptive orders to permit the acquisition of puts, but thus far, only under limited circumstances and subject to certain conditions.[10] Accordingly, a fund requiring exemptive relief in order to acquire puts or standby commitments must still seek an individual exemptive order. If in the future the issues concerning the acquisition of puts are resolved, the rule may be amended.

Maturity of Portfolio Instruments

A money market fund may rely on the rule only if its entire investment portfolio consists of instruments with a remaining maturity of one year or less. As prescribed in the rule, which is generally a codification of positions taken by the Commission regarding the conditions contained in the exemptive orders, the maturity of an instrument generally is deemed to be its stated maturity, with a special exception provided for certain variable and floating rate paper. Accordingly, an instrument is deemed to satisfy the one year or less maturity requirement for purposes of the rule if, on the date of purchase[11] by the money market fund: (i) The instrument, regardless of the length of maturity when originally issued, currently has no more than 365 days remaining until the principal amount owed is due to be paid, or, in the case of an instrument called for redemption, until the date on which the redemption payments must be paid,[12] or when originally issued, the principal amount due was to be paid in not more than 375 days[13]; (ii) where the instrument has a variable rate of interest[14] and is issued or guaranteed by the United States government or any agency thereof, it has no more than 365 days remaining until the next readjustment or renegotiation of the interest rate to be paid, regardless of the stated maturity of the instrument, and the board of directors has determined that it is reasonable to expect[15] that when the rate is readjusted it will cause the instrument to have a current market value which approximates its par value;[16] (iii) the

[7] There are basically two types of risk which cause fluctuations in the value of money market fund portfolio instruments: the market risk, which primarily results from fluctuations in the prevailing interest rate, and the credit risk. In general, instruments with shorter periods remaining until maturity and which are of higher quality have reduced market and credit risks and thus tend to fluctuate less in value over time than instruments with longer remaining maturities or of lesser quality.

[8] The applications for exemptive relief have routinely set forth the specific types and quality of instruments in which money market funds could invest. The instruments consisted exclusively of debt obligations, including such instruments as treasury bills and notes and other government issued or guaranteed debt securities, certificates of deposit and time deposits from domestic banks and thrift institutions and from foreign banks, bankers' acceptances of domestic and foreign banks, commercial paper, corporate bonds and notes and repurchase agreements on other debt obligations. While the rule does not set out the various types of debt instruments in which a money market fund relying on the rule may invest, the rule does require that all portfolio instruments mature in one year or less and be of high quality. The types of instruments a particular fund may invest in are, of course, further limited by its choice of investment policy. *See also*, footnote 2, *supra*.

[9] The Commission considers the terms puts and standby commitments to encompass any agreement by a third party to purchase, at some future date and at a prescribed price, a security issued by another party. Hence, instruments which include a demand feature where the demand obligation runs to a third party will be considered to be subject to a put. Compare the investments made by Daily Tax Free Income Fund, Inc. (File No. 2-78513), in participation interests issued by banks in industrial development bonds, which were regarded as instruments having a demand feature running to the issuer and not instruments subject to puts, and a letter to the Honorable Lee Sherman Dreyfus, Governor of Wisconsin, dated October 22, 1982 (publicly available March 3, 1983), discussing the applicability of proposed rule 2a-7 to proposed bonds.

[10] *See, e.g.*, Investment Company Act Release No. 11867 (July 21, 1981). The Commission intends to propose a rule in the near future which will include, among other measures, a codification of orders granted under Section 12(d)(3) [15 U.S.C. 80a-12(d)(3)] to permit the acquisition of puts from brokers or dealers for limited purposes.

[11] The date of purchase is regarded as the date on which the fund's interest in the instrument is subject to market action. Thus, for securities purchased under normal settlement procedures, the length of maturity would be calculated starting on the trade date. For instruments such as "when issued" securities (securities purchased for delivery beyond the normal settlement date), if the commitment to purchase the instrument includes either a set price or yield, then the maturity will be calculated based upon the commitment date. *See also* Investment Company Act Release No. 10666 (April 18, 1979), 44 FR 25128 (April 27, 1979) for a discussion of other issues raised by the purchase of instruments that subject the fund to risk prior to the actual inclusion of the instrument in the fund's portfolio.

[12] This portion of the definition of "one year" was expanded from that contained in the proposed rule in response to comments received by the Commission. Under the rule an instrument would be deemed to have a maturity of one year or less if either that particular instrument or the entire issue was to be redeemed within the year period. When determining whether an instrument called for redemption presents minimal credit risks to the fund (conditons (a) (2) (iv) and (a) (3) (iii)) the board should consider the risk that the obligation will not be honored on the redemption date.

[13] This part of the definiton has been extended beyond the usual definition of one year (365 days) to encompass securities, particularly government securities such as project notes, which are denominated as and intended to be "one year" notes but which occasionally are issued with maturities slightly longer than 365 days. (*See* Investment Company Act Release No. 11679 (March 11, 1981).) This part of the definition is not meant to encompass securities which were originally issued and intended to be longer than "one year" instruments. Those instruments could be purchased by a money market fund relying on this rule only if they have 365 or fewer days remaining until maturity.

[14] Variable rate instruments are those instruments whose terms provide for automatic establishment of a new interest rate on set dates.

[15] The language of this requirement was modified from that originally proposed to clarify that the rule requires only that the board make a reasonable evaluation of the instrument, not be insurers of the instrument.

[16] This definition, which goes beyond a codification of orders issued, was expanded based upon the Commission's understanding that the volatility of such instruments would not be greater than the volatility of fixed interest rate instruments having a maturity equal to the readjustment period of the U.S. government guaranteed variable rate notes. However, the Commission's position is based entirely upon experience with Small Business Administration guaranteed debentures ("SBA notes") which are the only instruments currently falling within this category so far as the Commission is aware. Accordingly, the board of directors of a money market fund considering investment in any such instrument other than a SBA note should, as a part of its overall duty to supervise the operations of the fund to ensure stability, determine that it can expect the volatility of such notes not to differ materially from the volatility of fixed rate notes of the same quality. Moreover, the Commission will consider amendment of this or any other provision of the rule if market experience indicates that it is inappropriate to the rule's overall purposes.

instrument (a) has a demand feature which allows the fund unconditionally to obtain the amount due from the issuer[17] upon notice of seven days or less,[18] (b) has either a floating rate of interest[19] or a variable rate of interest that is readjusted no less frequently than once per year,[20] where, in the case of a variable rate instrument, the board of directors has determined that it is reasonable to expect that whenever a new rate is established it will cause the instrument to have a current market value which approximates its par value and in the case of a floating rate instrument the board has determined that it can reasonably conclude that such floating rate feature will operate in such a way that the market value of such instrument will always approximate its par value,[21] and (c) will be reevaluated by the board at least quarterly to ensure that the instrument is of high quality;[22] or (iv) where the instrument is a repurchase agreement or an agreement upon which portfolio instruments are lent ("portfolio instrument lending agreement")[23] regardless of the maturity of the securities serving as collateral for the agreement, the repurchase is scheduled to occur or the loaned securities are scheduled to be returned within 365 days or less.[24]

The rule places the ultimate responsibility for the quarterly quality determinations and the determinations about the readjustment of the interest rate on the board of directors. However, the day to day functions involved in making such determinations may be delegated by the board to the investment adviser, so long as the delegation is done in a reasonable fashion, meeting the standards for reasonable board oversight articulated elsewhere in this release.[25]

Maturity of the Portfolio

In addition to requirements regarding the maturity of individual portfolio investments, the rule imposes restrictions on the dollar-weighted average maturity of the entire portfolio. Paragraphs (a)(2)(iii) and (a)(3)(ii) of the rule provide that a money market fund must maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable price per share. This provision imposes an obligation on the directors of the fund to ascertain that the fund is maintaining an average portfolio maturity that, given the then current market conditions, will permit it to maintain a stable price or net asset value per share. During periods of higher volatility in the market, the board of directors should be aware of the greater difficulty in maintaining a stable price or net asset value per share and should take steps to ensure that they are providing adequate oversight to the money market fund. In addition, the rule provides that in no event shall the fund maintain a dollar-weighted average portfolio maturity that exceeds 120 days. Should the disposition of a portfolio instrument or some market action cause the dollar-weighted average portfolio maturity to exceed 120 days, the board of directors is obligated to cause the fund to invest its available cash in a way that will reduce its dollar-weighted averaged portfolio maturity to 120 days or less as soon as reasonably practicable.

For purposes of computing the average portfolio maturity, instruments generally will be deemed to have a maturity equal to the period remaining until the date of maturity of the instrument noted on its face. Instruments which have been called for redemption are deemed to have a maturity equal to the period remaining until the redemption payment is to be made. Certain variable or floating interest rate instruments, which meet the conditions enumerated in the prior section of this release and are deemed to have a remaining maturity of one year or less for purposes of the rule,[26] may be treated as having a maturity other than that noted on the face of the instrument. Any such variable rate instruments with demand features may be deemed to have a maturity equal to the longer of the period remaining until the next rate readjustment or the period remaining until the principal amount can be recovered through demand.[27] Any such floating interest rate instruments with a demand feature may be treated as having a maturity equal to the period remaining until the principal amount due on the instrument can be recovered through demand.[28] Any such variable

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[17] In theory, the existence of a demand feature alone, *i.e.*, with no variable or floating rate feature, should be sufficient to enable a fund to maintain a stable net asset value per share because the holder could receive the principal amount of the instrument in a short period of time regardless of market and creditworthiness changes. However, the Commission has insufficient evidence that (1) funds will exercise such a demand feature whenever interest rates increase or the creditworthiness of the issuer is reduced and (2) there is a market for such instruments and even if there is, whether it always evaluates the instrument at a price approximating its par value. The demand feature, however, must run to the issuer. *See* footnote 9, *supra*.

[18] A demand note subject to a notice period of five business days would be deemed to satisfy this provision of the rule even if intervening weekends and holidays could cause the notice period, under same circumstances, to run more than seven calendar days.

[19] Floating rate instruments are those instruments whose terms provide for automatic adjustments of their interest rates whenever some other specified interest rate changes, where such specified interest rate is changed as market conditions change, rather than upon some periodic basis.

[20] *See* application of Municipal Fund for Temporary Investment, (File No. 812–4970) filed September 15, 1981, ordered March 5, 1982, (Investment Company Act Release No. 12278); and letter from Gerald Osheroff, Associate Director, Division of Investment Management to Joel T. Matcovsky, Merrill Lynch Asset Management, Inc., dated December 10, 1981.

[21] By this requirement, the Commission does not expect the board to be an insurer of the instrument. However, the provision requires that the instrument be evaluated as to whether an expectation of reaching the result set forth in the rule is reasonable.

[22] If the instrument were ever deemed to be of less than high quality, the fund either would have to sell the instrument or exercise the demand feature, whichever were more beneficial to the fund.

[23] Repurchase agreements may be regarded as securities issued by the entity promising to repurchase the underlying security at a later date (*See* Securities Act Release No. 6351 (September 25, 1981), 46 FR 48637 (October 2, 1981) and Investment Company Act Release No. 10666 (April 18, 1979), 44 FR 25128 (April 27, 1979).) Therefore, a money market fund is generally prohibited by the provisions of section 12(d)(3) of the Act (15 U.S.C. 80a–12(d)(3)) from acquiring a repurchase agreement issued by a broker or dealer unless it structures the repurchase arrangement in accordance with the manner described in the Investment Company Act release, which is designed to ensure that the investment company's investment, including accrued interest earned, is fully collateralized. *See* however, footnote 31, *infra*. The same analysis may apply to portfolio instrument lending agreements.

[24] Repurchase agreements and portfolio instrument lending agreements which have no specified date, but rather are subject to demand, have generally been regarded as having a maturity equal to the notice period required. The rule as adopted reflects this treatment.

[25] Money market funds investing in, or seeking to invest in, an instrument with a maturity not falling within one of the above-described categories (i) through (iv) would not be able to rely upon the rule to permit the use of either penny-rounding or the amortized cost valuation method. Thus, funds wishing to invest in other types of instruments will have to file individual applications for exemptive relief.

[26] *See* the discussion on Maturity of Portfolio Instruments, which sets forth the conditions that must be fulfilled in order for the maturity to be deemed a period other than that remaining until the maturity date noted on the face of the instrument.

[27] Because certain of such variable rate demand instruments may not be readily marketable, the demand notice period may be the shortest period during which the holder may practically expect to bear the market risk associated with the instrument. However, because the Commission believes that the demand features of such instruments are seldom used except for liquidity purposes, holders will usually be exposed to market risk during the period remaining to the date of the next interest rate adjustment.

[28] If the board determined that a demand instrument, either floating or variable rate, were no longer of high quality, the fund could not base its maturity on the period remaining until recalculation of the interest rate or on the demand period, but, as noted at footnote 22 *supra*, would have to exercise the demand feature or sell the instrument, whichever were more beneficial to the fund.

rate instruments (issued or guaranteed by the U.S. government or an agency thereof) that do not have a demand feature may be treated as having a maturity equal to the period remaining until the next calculation of the interest rate rather than the period remaining until the principal amount is due. Repurchase agreements and portfolio instrument lending agreements shall be treated as having a maturity equal to the period remaining until the repurchase is scheduled to occur or the loaned-instruments are scheduled to be returned. When no date is specified but the agreements are subject to demand, the maturity shall be based upon the notice period required.[29] Finally, although variable rate instruments with neither a United States government or government agency guarantee nor a demand feature may be purchased only if the period until the maturity date set on the face of the instrument is one year or less, the rule will permit, for purposes of determining the dollar-weighted average maturity of the entire portfolio under the rule, such instruments to be treated as having a maturity equal to the period remaining until the next readjustment of the interest rate, provided that the board determines that it is reasonable to expect that the new rate will cause the instrument to have a current market rate which approximates its par value.[30]

Quality of Portfolio Instruments

In addition to the above limitations on the maturity of the portfolio of a money market fund seeking to rely on the rule, paragraphs (a)(2)(iv) and (a)(3)(iii) of the rule contain conditions relating to the quality of all portfolio instruments. The rule provides that each portfolio instrument must be denominated in United States dollars and must also be an instrument which: (1) The board had determined presents minimal credit risks to the fund; and (2) is rated "high quality" by a major rating service or, if the security is unrated, is determined by the board to be of comparable quality.[31]

The Commission received conflicting comments regarding the quality standards that should be imposed under the rule. Some commentators believed that the rule should rely totally upon fund management to judge the quality of instruments and recommended deleting the requirement that the instruments, if rated by a third party, receive a high quality rating. Other commentators suggested that the requirement that the board find that the instrument presents minimal credit risks is superfluous and that the rule should require only a finding of high quality. Regardless of what standard was imposed, a substantial number of commentators believed that the board should not be involved in the quality determination at all, and that the determination should be made by the investment adviser.

The Commission believes that both tests are significant and, therefore, has retained both in the rule. The requirement that a security have a high quality rating provides protection by ensuring input into the quality determination by an outside source. However, the mere fact that an instrument has or would receive a high quality rating may not be sufficient to ensure stability. The Commission believes that the instrument must be evaluated for the credit risk that it presents to the particular fund at that time in light of the risks attendant to the use of amortized cost valuation or penny-rounding. Moreover, the board may look at some aspects when evaluating the risk of an investment that would not be considered by the rating services.

As stated earlier, the Commission believes that the ultimate responsibility for the quality of portfolio instruments should be placed on the board of directors, who have undertaken special responsibilities designed to ensure stability of the fund. However, as discussed earlier, although the rule provides that the fund will invest only in those instruments which the board has determined to be of sufficient quality, the Commission will not object to the delegation of the day-to-day function of determining quality, provided that the board retains sufficient oversight. An example of acceptable delegation would be for the board to set forth a list of "approved instruments" in which the fund could invest, such list including only those instruments which the board had evaluated and determined presented minimal credit risks.[32] The board could also approve guidelines for the investment adviser regarding what factors would be necessary in order to deem a particular instrument as presenting minimal credit risk. The investment adviser would then evaluate the particular instruments proposed for investment and make only conforming investments. In either case, on a periodic basis the board should secure from the investment adviser and review both a listing of all instruments acquired and a representation that the fund had invested in only acceptable instruments. The board, of course, could revise the list of approved instruments or the investment factors to be used by the investment adviser.

[29] Although repurchase agreements ("repos") will be treated as having a maturity based upon the length of the agreement and not the maturity of the instruments which serve as collateral, the board of directors should be aware of the risks involved with the purchase of repos that are collateralized by instruments with remaining maturities of greater than one year. If the issuer of the repo should default, the instrument serving as collateral would become a part of the money market fund's portfolio. Instruments with longer maturities generally have greater volatility and thus would expose the fund to a greater risk of an unstable price per share. Moreover, the instrument would not satisfy the provisions defining permissible portfolio instruments. Therefore, the Commission would take the position that such a security should not become a part of the portfolio and must be disposed of as soon as possible. Of course, if the default is due to bankruptcy, the fund may be unable to perfect its possession of the collateral. (*See* footnote 31, *infra*.) The same analysis would apply to transactions where the money market fund loans portfolio instruments and instruments having maturities of greater than one year are received as collateral for the loan. If the borrower defaults, the fund would be left with instruments which would not meet the provisions of the rule. Under the same analysis, these instruments should not become a part of the portfolio and must be disposed of as soon as possible.

[30] This provision reflects a slight expansion of the relief given through exemptive order, which required periods of renegotiation to be 30 days or less and the remaining maturity of the instrument to be 180 days or less. (Investment Company Act Release No. 11679 (March 11, 1981).)

[31] With regard to investments in repurchase agreements ("repos"), the Commission believes that in determining whether the investment meets the quality provisions of the rule, the board must look both to the quality of the issuer of the promise to repurchase as well as the quality of the underlying collateral. More specifically, in determining whether the repo presents minimal credit risks, the fund must assess the credit risk involved in getting payment in a timely fashion. That assessment must include an evaluation of the issuer's creditworthiness as well as the creditworthiness of the collateral, since the financial position of the issuer may affect the fund's ability to obtain the collateral. Given the uncertain status of repos under the Bankruptcy Code, mutual funds face certain risks if they invest in repos issued by a party that subsequently initiates bankruptcy proceedings. *See, e.g., In re Lombard-Wall, Inc.*, Reorganization Case No. 82 Bkcy 11556 (EJR) (Bankr. S.D.N.Y., filed Aug. 12, 1982). Investment Company Act Release No. 13005 (February 2, 1983), 48 FR 5894 (February 9, 1983) sets forth specific suggestions concerning factors that may assist funds in evaluating the creditworthiness of repo issuers. Although the board must look to both the issuer of the repo and the underlying collateral when determining minimal credit risk, the Commission believes that in making a "high quality determination," it is appropriate for the board to look solely to the quality of the underlying collateral.

The Commission regards only that portion of the agreement which is fully collateralized to be the "repurchase agreement" subject to the treatment discussed above. Any agreement or portion of an agreement which is not fully collateralized would be regarded as an unsecured loan. As such, the loan itself would be required to meet the quality requirements set forth in the rule, both in terms of presenting minimal credit risks and high quality rating.

[32] The Commission envisions that the investment adviser would provide the board with the data to evaluate the instruments and make its assessment.

Again, these examples are not meant to set the exclusive methods by which the board could fulfill its responsibilities. However, they are meant to provide guidance as to what the Commission would consider adequate oversight. Generally, adequate oversight would involve the board satisfying itself in advance that the methods to be used by the adviser in fulfilling the functions are correct, and then reviewing the adviser's actions. However, the Commission is of the view that the board would not be complying with the requirement to review the quality of the fund's portfolio instruments if it merely approved the transactions in which the fund engaged, after the fact.

In order to fulfill the rule's requirements that the instruments be rated "high quality," the instruments, if rated, must have been given a rating by a major financial rating service such as Standard & Poor's Corporation, Moody's Investors Services or Fitch Investors Service [33] that would be considered high quality.[34] Even if the board of directors believes that the rating service incorrectly rated the instrument too low or that because of changed circumstances the instrument is now of higher quality, this provision of the rule precludes a money market fund which is relying on the rule from investing in any rated instrument which does not have a "high quality" rating.[35]

If an instrument has received no rating from a major rating service, then, assuming that the board has found that it presents minimal credit risks to the fund, it would be a permissible investment under the rule, provided that the board also finds that the instrument is of "comparable quality" to that of instruments that are rated "high quality".[36]

In meeting the rule's requirement that the fund invest only in those securities which the board determines to meet certain quality standards, the board may delegate to the investment adviser the responsibility for investigating and judging the creditworthiness of particular instruments. However, like the procedures discussed above, the board must exercise sufficient oversight if it wishes to delegate this function to the investment adviser. Again, sufficient oversight would involve the board setting guidelines, its approval of the adviser's methods in advance and routine surveillance of the adviser's performance.

Liquidity of the Portfolio

While the rule does not limit a money market fund's portfolio investments solely to negotiable and marketable instruments, money market funds, like all open-end management investment companies, are subject to limitations on restricted or illiquid securities. In Investment Company Act Release No. 5847 (October 21, 1969), 35 FR 19989 (December 31, 1970) ("Release 5847"), the Commission set forth its view that, because an open-end company has an obligation to value its portfolio correctly and to satisfy all redemption requests within the statutorily prescribed period, it must limit its acquisition of restricted securities and other securities not having readily available market quotations to the extent necessary to ensure that it can fulfill its obligations. In addition, the Commission took the position that, in light of those obligations, in no event should the percentage of such securities exceed ten percent of the company's net assets. Money market funds relying on the rule, like any other open-end management company, must limit their portfolio investments in illiquid instruments [37] to not more than ten percent of their net assets.[38] However, because of the nature of money market funds, the difficulties that could arise in conjunction with the purchase of illiquid instruments by such funds might be even greater than for other types of open-end management investment companies. Therefore, the board of directors of a money market fund relying on the rule may have a fiduciary obligation to limit further the acquisition of illiquid portfolio investments.

While the Act requires only that an investment company make payment of the proceeds of redemption within seven days,[39] most money market funds promise investors that they will receive proceeds much sooner, often on the same day that the request for redemption is received by the fund. In addition, most money market funds, because they are primarily vehicles for short-term investments, experience a greater and perhaps less predictable volume of redemption transactions than do other investment companies. Thus, a money market fund must have sufficient liquidity to meet redemption requests on a more immediate basis. By purchasing or otherwise acquiring illiquid instruments, a money market fund exposes itself to a risk that it will be unable to satisfy redemption requests promptly.

In addition, as set forth in Release 5847, management of the investment company's portfolio could also be

[33] Standard & Poor's Corporation ("Standard & Poor's"), Moody's Investors Services ("Moody's") and Fitch Investors Service ("Fitch") are set forth as examples of rating services that are considered by the Commission to meet the definition of a major financial rating service. The Commission does not intend to prescribe that the ratings must come only from one of these three services.

[34] Using bonds as an example, Moody's defines "high quality" for bonds to be those instruments which receive an Aaa or Aa rating. Similarly, the Commission would consider bonds rated AAA or AA by Standard & Poor's or by Fitch to be high quality. Therefore, a money market fund seeking to rely on this rule could invest only in bonds which were rated AA (Aa) or better. Commercial paper receiving one of the two top ratings (Prime-1 or 2, A-1 or 2, or Fitch-1 or 2) also would be considered high quality. The rule requires only that an instrument receive a "high quality" rating from one major financial rating service. In a case where an instrument received different ratings from different services, the instrument would be an acceptable investment so long as at least one rating was a high quality rating and provided that the board found that the instrument presented minimal credit risks.

[35] However, a rated instrument that is subject to some external agreement (such as a letter of credit from a bank), where such external agreement was not considered when the instrument was given its rating, for purposes of this rule, will be considered an unrated security. The Commission believes that agreements such as letters of credit can significantly affect the credit risk associated with an instrument. Therefore, since the security may have significant characteristics which are not included in the rating, it is appropriate to consider a security subject to an external agreement, as an unrated security, and thus permit the board to determine whether the instrument, taking into account the external agreement, is of comparable quality.

If the board were to consider an external agreement as a basis for judging the quality of an underlying security, that external agreement would have to be unconditional and have terms coextensive with those of the underlying security. Moreover, the instrument could not be judged to be of better quality than that of comparable debt securities of the issuer of the external agreement. It should be noted, however, that if the rating service included the external agreement in its calculation of the rating, the instrument will be regarded as a rated instrument, regardless of the board's lack of concurrence with the rating.

[36] As noted above, provided that certain conditions are met, third party agreements may be analyzed in evaluating whether an instrument is of sufficient quality.

[37] Illiquid instruments, in this context, would generally encompass any instrument which cannot be disposed of promptly and in the usual course of business without taking a reduced price. This would include, but is not limited to, repurchase agreements for greater than seven days, non-negotiable instruments, and instruments for which no market exists. *But cf.* the discussion in the text preceding footnote 45, *infra*, of the treatment of a non-negotiable instrument, which may be redeemed with the issuer subject to a penalty. Where the fund is using amortized cost valuation, such an instrument need not be regarded as an illiquid security if, when the fund monitors the deviation, it uses a market value for such security, which includes the effect of the penalty charge.

[38] In the event that changes in the portfolio or other external events cause the investments in illiquid instruments to exceed ten percent of the fund's net assets, the fund must take steps to bring the aggregate amount of illiquid instruments back within the prescribed limitations as soon as reasonably practicable. However, this requirement generally would not force the fund to liquidate any portfolio instrument where the fund would suffer a loss on the sale of that instrument.

[39] Section 22(e) of the Act [15 U.S.C. 80a-22(e)].

affected by the purchase of illiquid instruments. If the investment company found that it was forced to sell portfolio instruments in order to satisfy redemptions, it might sell marketable securities which it would otherwise wish to retain in order to avoid attempting to dispose of non-negotiable instruments or other illiquid instruments, since the sale of non-negotiable or illiquid securities would necessitate the money market fund's accepting a reduced price. The judgment concerning which securities would be retained would no longer be based upon comparative investment merit. Therefore, the board of directors has a particular responsibility to ensure that when a money market fund purchases or acquires illiquid instruments, such instruments will not impair the proper management of the fund.

Finally, the purchase of illiquid instruments can seriously complicate the valuation of a money market fund's shares and can result in the dilution of shareholders' interests. If illiquid instruments which were valued at amortized cost were disposed of at a reduced price, then, in retrospect, the net asset value of the money market fund would have been overstated. Similarly, if illiquid instruments were valued at a discounted value (to compensate for the possibility that they may have to be disposed of prior to maturity), but were held to maturity and thus yielded their full value, the net asset value of the money market fund would have been understated. Regardless of the types of instruments purchased, the board of directors of a money market fund is under the same obligation to ensure that the price per share correctly reflects the current net asset value per share of the fund. Therefore, when a fund purchases illiquid instruments, the board of directors has a fiduciary duty to ascertain that the fund is operated in such a manner that the purchase of such instruments does not materially affect the valuation of the fund's shares.

Obligation of the Board to Maintain Stable Price

A money market fund that describes itself in its prospectus as having or seeking to maintain a stable price per share through portfolio management and use of a special pricing or asset valuation method has an obligation to its shareholders to continue the chosen method so long as it is consistent with the provisions of the Act, until shareholders are notified of a change in policy. The Commission believes that where a money market fund adopts either the amortized cost valuation or penny-rounding pricing method under the rule to enhance its ability to maintain a stable price it has a heightened responsibility to shareholders to maintain that stable price. Accordingly, under paragraphs (a)(2)(i) and (a)(3)(i) of the rule, the board of directors of a money market fund wishing to use either penny-rounding or the amortized cost valuation method has a particular obligation to assure that the fund is managed in such a way that a stable price will be maintained.

The rule as originally proposed contemplated that funds using either the amortized cost method or penny-rounding method would stabilize their net asset value per share or their price per share, respectively, at $1.00. In so doing the Commission did not wish to foreclose funds from using a single stabilized value other than $1.00, but was merely codifying what seemed to be an industry practice. The Commission received a few comment letters which expressed the desire to have some flexibility in the value at which a fund would be stabilized. Therefore, paragraphs (a)(2)(i) and (a)(3)(i) of the rule were revised to permit funds using amortized cost or penny-rounding to stabilize the net asset value per share or price per share, respectively, at a single value, rather than specifically at $1.00.

For a fund seeking to use the amortized cost valuation method, the board of directors has a responsibility to establish procedures reasonably designed to stabilize the fund's net asset value per share. For a fund seeking to use the penny-rounding method, the board of directors has a responsibility, through its supervision of the fund's operations and delegation of special responsibilities to the investment adviser, to assure, to the extent reasonably practicable, that the money market fund's price per share remains stabilized at the single value selected.[40]

Testimony by witnesses from the investment company industry presented at the hearings on the original applications for amortized cost valuation alleged that with the limitations on quality and length of maturity provided, short of extraordinarily adverse conditions in the market, a money market fund that is propertly managed should be able to maintain a stable price per share.[41] The orders granting exemptive relief and this rule, which codifies those orders, are premised on that representation. Therefore, the Commission believes that if a money market fund relying on this rule is unable to maintain a stable net asset value per share, and this inability is not due to highly unusual conditions affecting the money markets in general, there is a strong presumption that the board of directors has not fulfilled its obligation to ensure that the fund is properly managed.[42]

Monitoring the Fairness of the Valuation or Pricing Method

In addition to the restrictions on the types of portfolio investments that may be made, the provisions of the rule impose obligations on the board of directors to assess the fairness of the valuation or pricing method and take appropriate steps to ensure that shareholders always receive their proportionate interest in the money market fund. Paragraph (a)(1) of the rule provides that the board of directors of each money market fund relying on the rule must determine that the valuation or pricing method selected is in the best interests of the shareholders of the fund. That finding must be made prior to the implementation of the selected method, and the board must continue thereafter

[40] The rule mandates that the board act in some specific ways to fulfill its responsibility to ensure a stable net asset value or price: having the fund maintain an appropriate dollar-weighted average maturity and permitting the fund to invest only in instruments which present a minimal credit risk and are of high quality. Thus, for example, it appears that the board of directors should, absent extenuating circumstances which would cause such action not to be in the best interest of the fund, cause the money market fund to dispose of any security as soon as practicable, if the quality of that instrument falls below "high quality." *See also* footnote 22, *supra*.

[41] Proceedings before the Securities and Exchange Commission in the Matter of InterCapital Liquid Asset Fund, Inc., *et al.*, 3-5431, December 20, 1978, at 1414.

[42] The Commission received several negative comments in response to this view. These commentators stated that no presumption of failure by the board to fulfill its responsibilities should flow from the fund's failure to maintain a stable net asset value per share and that the Commission should focus upon whether the procedures adopted were reasonable. As stated elsewhere in this release, the Commission does not expect the board of directors to be insurers of the activities of the investment adviser or of the fund. The Commission has evaluated in the past, and would similarly evaluate in the future, the actions of the board of directors based upon a reasonable business standard. However, in permitting funds to use the amortized cost valuation method, the Commission was assured that under all but extreme circumstances, the responsibilities imposed by the rule, if fulfilled, would produce stability. The rule and the specific exemptive orders provide the board with substantial discretion in adopting procedures to achieve this end. The mere adoption of those specific procedures required in the rule and exemptive orders will not, *per se*, fulfill the board's responsibilities. On the other hand, if a board adopts procedures which are reasonably designed to assure stability and the board acts in a reasonable fashion to assure that those procedures are followed, the Commission would not hold the board responsible for any failure to maintain a stable net asset value per share.

to believe that the method fairly reflects the market-based net asset value per share.[43] Moreover, the minutes should reflect the finding and include the factors that were considered by the board and the board's analysis of those factors in reaching its conclusion. The rule imposes an obligation on the board to discontinue the use of the selected valuation or pricing method if it ceases to reflect fairly the market-based net asset value per share. In that case, the fund's current price and net asset value per share would ordinarily have to be determined in conformance with the provisions of section 2(a)(41) of the Act [15 U.S.C. 80a-2(a)(41)] and rules 2a-4 and 22c-1 thereunder [17 CFR 270.2a-4 and 270.22c-1].

In addition to the general obligation to assess the fairness of the valuation or pricing system, paragraph (a)(2)(ii) of the rule requires the board of a money market fund relying on this rule and using the amortized cost method of valuation to adopt procedures whereby the board periodically will review the monitoring of the deviation between the per share net asset value based on the market value of the portfolio ("market-based value") and the price per share computed from a net asset value per share calculated using the amortized cost valuation of the portfolio, which must be performed at intervals that are deemed appropriate by the board and are reasonable in light of current market conditions. In addition, the rule requires the maintenance of a record of both functions. The rule does not prescribe specific intervals for such monitoring; however, the board must select intervals that are reasonable "in light of current market conditions." This means that the reviews should be frequent enough so that the board may become aware of changes in the market-based per share net asset value before they become material. During periods of high market volatility, this requirement may necessitate that the deviation between such market-based value and price be monitored on a daily basis. During periods of lower volatility, it may be reasonable to monitor such deviation less frequently.

As with other functions required by the rule, the board is not compelled to perform the actual day-to-day monitoring itself. That function may be performed by the investment adviser or some other entity. However, the board is ultimately responsible for the monitoring function. The board does not fulfill its responsibility to review such monitoring by merely requiring the investment adviser to notify it at some designated benchmark, unless the board has a reasonable basis for believing that the portfolio is being correctly and appropriately monitored. In order to have such a reasonable basis, the Commission believes that the board should assure itself that the intervals between monitoring will be changed as appropriate to be responsive to changing market conditions and that the monitoring process will include an appropriate method to determine the market value of each type of instrument contained in the fund's portfolio. In addition, the Commission believes that periodically the board should review the actual monitoring calculations.

In determining the market-based value of the portfolio for purposes of computing the amount of deviation, all portfolio instruments, regardless of the time to maturity, should be valued based upon market factors and not their amortized cost value.[44] That value should reflect the amount that would be received upon the current sale of the asset. Accordingly, a non-negotiable instrument which is not treated as an illiquid security because it may be redeemed with the issuer, subject to a penalty for early redemption, must be assigned a value for monitoring purposes which takes into account the reduced amount that would be received if it were currently liquidated.[45]

The rule was modified slightly to indicate explicitly that the monitoring may be performed with suitable substitutes for market quotations. The Commission will not object if a fund, with the approval of its board, determines the market-based value of each instrument using estimates of market value which reflect current market conditions or using values derived from yield data relating to classes of money market instruments obtained from reputable sources, provided that certain minimum conditions are met. Where estimates of market value rather than actual quotations are used, the board should review and approve the method by which such estimates will be obtained. Any pricing system based on yield data for selected instruments used by a fund must be based upon market quotations for sufficient numbers and types of instruments to be a representative sample of each class of instrument held in the portfolio, both in terms of the types of instruments as well as the differing quality of the instruments. Moreover, periodically, the board should check the accuracy of the pricing system or the estimates. If the fund uses an outside service to provide this type of pricing for its portfolio instruments, it may not delegate to the provider of the service the ultimate responsibility to check the accuracy of the system.

The rule does not include a specific requirement that a money market fund using the penny-rounding method monitor the market-based value of its shares because such market-based valuation generally is itself the basis for the calculation of the per share net asset value upon which the price per share is computed. However, where a penny-rounding money market fund uses the amortized cost method to value portfolio instruments with remaining maturities of 60 days or less,[46] monitoring the deviation between the net asset value per share calculated using the market based value of all its portfolio instruments and its price per share may

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[43] This requirement was not explicitly listed as a condition of the prior exemptive orders; however, the obligation existed as a result of: (1) the general obligation of a board to value portfolio instruments at fair value, which would cause the net asset value per share to reflect fairly each shareholder's interest, and (2) the specific condition of the orders that required the board to take action to eliminate any potential for dilution or unfair results, which might include ceasing to use the amortized cost method.

[44] Release 9786 set forth the Commission's position that it would not object to a board of directors determining, in good faith, that it was appropriate for a money market fund to value securities with less than 60 days remaining until maturity at amortized cost, unless the particular circumstances dictate otherwise. The impact of that release was to obviate the necessity of exemptive relief for such valuation. Thus, while it may be appropriate for the board to value certain portfolio securities at amortized cost without adherence to the conditions contained in the rule, Release 9786 does not affect the monitoring procedures under this rule. Where the fund is using amortized cost valuation to such an extent that exemptive relief is necessary, *i.e.*, its portfolio contains any security with a maturity in excess of 60 days, the monitoring procedures contained in the rule are designed to place a limitation on the total deviation between the fund's amortized cost value and its market-based value. In order to calculate precisely that total deviation, all instruments must be valued at market value. In addition, prudence would seem to suggest that funds which are relying solely on Release 9786 in order to allow them to use the amortized cost method of valuing their portfolio securities should institute procedures to monitor whether any "particular circumstances" have developed which make the use of amortized cost no longer appropriate.

[45] A non-negotiable instrument, which may be put back to the issuer subject to a penalty may be treated as a liquid security, provided that for monitoring purposes the market value assigned to the instrument includes the effect of the penalty, or it may be treated as an illiquid security, with no reduction in value to reflect the penalty charge; provided that the security is then counted towards the ten percent limitation on illiquid securities. A money market fund, especially a fund with expedited redemption features, should carefully consider, however, whether securities subject to a penalty may impair the fund's liquidity.

[46] *See* footnote 44, *supra*.

be necessary in order for the board to fulfill its responsibility to oversee the use of the penny-rounding method. If the price per share obtained through penny-rounding does not fairly represent each shareholder's interest in the fund, the board is obligated to use another pricing system which does fairly reflect each shareholder's interest. Particularly in a volatile market, if a penny-rounding fund were to use amortized cost valuation for a material portion of its portfolio, monitoring of actual market values might be necessary in order for the board to make a determination regarding the current fairness of prices obtained under the penny-rounding method. Moreover, the board's obligation to assure that the money market fund is maintaining an appropriate dollar-weighted average maturity to ensure stability may require that the per share net asset value based upon the market value of all the fund's portfolio instruments be monitored in order for the board to make a reasonable determination whether the maturity must be changed in order to ensure stability. The money market fund should retain a written record of any monitoring and the frequency of such monitoring should be appropriate in light of current market conditions.

Obligation of the Board to Take Action to Stabilize Net Asset Value Per Share

Pursuant to paragraph (a)(2)(i) of the rule, the board of directors of a money market fund using the amortized cost method must establish procedures reasonably designed, taking into account current market conditions and the fund's investment objectives, to stabilize the funds's per share net asset value at a singe price. While the rule does not mandate the specific content of the procedures other than as set forth in paragraph (a)(2)(ii), described below, the procedures must be in writing (paragraph (a)(2)(v)) and should provide for action on the part of the investment adviser or the board of directors to ensure that the per share net asset value remains stable. Since the rule prescribes only the minimum provisions that must be included in the procedures adopted by the board, the Commission emphasizes that the board should consider carefully what types of procedures it may wish to establish in order to satisfy the responsibilities to ensure stability and fair valuation undertaken in connection with selecting the valuation method. Examples of types of other procedures that boards may wish to consider adopting are: (1) "early warning systems" whereby the board establishes a procedure requiring the investment adviser to inform the board, and the board to meet and consider what action is appropriate to take, whenever the market based per share net asset value of the fund falls below or rises above some predesignated level; and (2) procedures which require the investment adviser to modify its portfolio purchases in specified ways as market conditions change.

The specific provisions prescribed in paragraph (a)(2)(ii) of the rule include an obligation that, in the event that the deviation between market-based net asset value per share and amortized cost price exceeds ½ of 1 percent [47] the board of directors will promptly consider what action, if any, should be initiated by the board. [48] In fulfilling that obligation, the Commission takes the position that it is inappropriate, and will not satisfy the condition, for the board of directors to determine that it need not take any action to stabilize the per share net asset value on the basis that the amount of deviation will be reduced over time by anticipated interest rate changes in the market. The Commission bases its position on the fact that the board has, by undertaking to establish procedures to stabilize the net asset value per share, obligated itself to take affirmative action to ensure stability. Because no one can forecast with certainty market trends, or at what point the fund might experience a large increase in redemptions, the Commission believes that a decision not to take any action to reduce the deviation, based upon a belief that market action will reduce the deviation, is not an action reasonably designed to ensure stability. [49]

The board is required additionally to take such action as it deems appropriate whenever it believes that the amount of deviation may result in material dilution or other unfair results to investors or existing shareholders. [50] The rule neither specifies what actions the board must take, nor lists, as orders of exemption have, possible courses of action. However, there is a variety of methods to reduce the deviation, including: Adjusting dividends; selling portfolio instruments prior to maturity to realize capital gains or losses or to shorten the average portfolio maturity of the money market fund; or redeeming shares in kind.[51]

In any event, as provided in paragraph (a)(1) of the rule, if the board were ever to determine that the deviation was such that it could no longer conclude that the amortized cost price fairly reflected the market-based net asset value per share, because of the possibility of dilution or other unfair results, it would have to discontinue use of the amortized cost method of valuation and calculate its price per

[47] In determining whether the deviation exceeds ½ of 1 percent, the market-based per share net asset value must be calculated to the nearest one-hundredth of a cent on a share value of one dollar with no rounding. Therefore, where a fund has an amortized cost price of $1.00, a market-based net asset value per share of .99500 would not be considered as exceeding the ½ of 1 percent mark, but a value of .99499 could not be rounded up and thus the deviation would be considered to exceed this benchmark.

[48] The Commission received a comment that the rule should be revised to permit corrective action to be taken either by the board or by the investment adviser pursuant to guidelines established by the board once the fund reached the point where the deviation exceeded ½ of 1 percent. While the Commission has no objection to the board directing the investment adviser to take the actual steps necessary to correct the deviation, it does not believe that the determination of what action should be delegated to the investment adviser, even if it is pursuant to board guidelines. The purpose of this provision is to have the board personally review the operations of the fund at a point which the Commission views as critical. Therefore, this portion of the rule remains unaltered. We note, however, that as discussed elsewhere in this release, the board may adopt procedures for the investment adviser to take corrective action within certain guidelines established by the board at stages prior to reaching ½ of 1 percent deviation.

[49] The Commission received a number of comments disagreeing with its view that the board is required to take affirmative action to stabilize the per share net asset value of the fund. Commentators expressed the view that the board should be given total discretion to exercise reasonable business judgment concerning what actions, if any, are needed to ensure stability. While the Commission agrees that the board should be given considerable discretion in determining how the fund should be operated to achieve the goal of stability, the rule and the exemptive orders require the board to operate within certain limitations that are designed to function as safety checks. Therefore, the Commission continues to take the position that the board should not have unfettered discretion. However, the Commission has modified its prior position to the extent that it will not necessarily regard a board's decision not to take action based upon the anticipated maturation of portfolio instruments as *per se* unreasonable. Any such decision, however, would be closely scrutinized to determine whether in light of the particular circumstances, such a decision was an action reasonably designed to ensure stability.

[50] It should be noted that this requirement of the rule does not depend upon a determination that the deviation *will* result in material dilution, only that it *may*. Because the Commission deems a deviation of ½ of 1 percent to be a material amount, under all but highly unusual circumstances, the Commission would find that a deviation exceeding ½ of 1 percent *may* result in material dilution or other unfair results to shareholders. Thus, it is unlikely that a board of directors could, in conformance with the provisions of the rule, make a finding that no action was necessary when the deviation reached that level. Moreover, a board may find that the possibility of material dilution exists when the deviation is less than ½ of 1 percent. In such an event, the board would also be obligated to take corrective action.

[51] The Commission is not proposing to codify such examples in order to avoid any implication that other actions would be inappropriate.

share in accordance with the provisions of the Act and rules thereunder.[52] It should be noted, however, that the board of directors must undertake, as a duty to shareholders, the responsibility of establishing procedures reasonably designed to preclude the necessity for such a switch in valuation methods.

Although the rule does not prescribe the specific actions that the board of directors of a fund using the penny-rounding method must take at a given time to assure that the price per share does not fluctuate, the rule explicitly imposes an obligation on the board to operate the fund in such a manner and, therefore, take action, to preclude a change in the price per share. As the net asset value per share begins to move away from one dollar, the board should consider, among other things altering the average portfolio maturity or the quality of instruments purchased to stabilize the current price per share at one dollar.

With the penny-rounding method, if the net asset value[53] ever fell below .99500 or rose above 1.00500 without rounding on a share value of $1.00, the fund would have to change its price per share to $.99 or $1.01, respectively, or would have to cease to use the penny-rounding method and calculate its price with the accuracy of at least a tenth of a cent. However, under the conditions of the rule, a fund may similarly have to adjust its price under another circumstance. As noted in Release 9786, a fund using penny-rounding may, if the board deems it appropriate, value portfolio securities with less than 60 days until maturity at amortized cost. If all securities held by such a fund were to be valued at market and the net asset value per share based upon those market values, rounded to the nearest one cent, did not fairly reflect the single price per share, then pursuant to paragraph (a)(1) of the rule the fund would have to cease to price its shares at the single price established by the board.

[52] Even without this provision of the rule, the board of directors has an obligation to discontinue a pricing method that does not fairly reflect the value of the fund's securities. As set forth in Release 9786, section 2(a)(41) requires the board of directors to value the fund's assets at fair value as determined in good faith. The language of this obligation was modified slightly in response to comments that indicated that the original language requiring the price to fairly reflect the value of each shareholder's interest was vague; that the shareholder's interest was the fair market value of a share and that the rule should be modified to reflect that.

[53] The net asset value must be calculated using market-based values for all instruments other than those with less than 60 days until maturity, which generally may be valued at amortized cost, unless particular circumstances dictate otherwise. *See* footnote 44, *supra*.

Record of Actions Taken to Stabilize Price

Under paragraph (a)(2)(v) of the rule a money market fund using the amortized cost method must maintain a written record that documents the board's compliance with its obligations under the rule, including its responsibility to consider and take action where mandated. The rule provides that the documentation, which should include a discussion of all instances where the board considered whether action should be taken and what actions were initiated, must be included in the minutes of the board of directors' meetings and must be preserved for six years. Such documentation must also be made available for inspection by the staff of the Commission. In addition, pursuant to paragraph (a)(2)(vi), if any action is taken pursuant to paragraph (a)(2)(ii)(C) of the rule, the board of directors shall cause the fund to file quarterly, as an attachment to Form N-1Q [17 CFR 274.106], a statement describing with specificity the circumstances surrounding the action and the nature of the action taken. This provision of the rule is a slight departure from the existing orders in that it requires funds to make a filing only if some action was taken.[54] The Commission believes that the modified filing requirement, in conjunction with the board's monitoring, will provide adequate controls over the use of the amortized cost valuation method and is in accord with the purposes of new provisions regarding the filing of Form N-1Q's and the reduced paperwork burdens thereof.[55]

List of Subjects in 17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Rule

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

Part 270 of Chapter II of Title 17 of the Code of Federal Regulations is amended by adding new § 270.2a-7, as follows:

[54] The existing orders require a quarterly filing stating whether or not any action was taken. In order to eliminate differential treatment, the Division will not recommend that the Commission take any action against a fund if it continues to rely on its individual exemptive order but follows the Form N-1Q reporting requirement contained in the rule.

[55] *See* Securities Act Release No. 6366 (December 16, 1981), 46 FR 62246 (December 23, 1981).

§ 270.2a-7 Use of the amortized cost valuation and penny-rounding pricing methods by certain money market funds.

(a) The current price per share, for purposes of distribution, redemption and repurchase, of any redeemable security issued by a registered investment company (hereinafter referred to as a money market fund), notwithstanding the requirements of section 2(a)(41) of the Investment Company Act of 1940 [15 U.S.C. 80a-2(a)(41)] and of rule 2a-4 [17 CFR 270.2a-4] and rule 22c-1 [17 CFR 270.22c-1] thereunder, may be computed either by use of the amortized cost method of valuation or by use of the penny-rounding method of pricing; *Provided*, That:

(1) The board of directors of the money market fund (trustees in the case of a trust) determines, in good faith based upon a full consideration of all material factors, that it is in the best interests of the fund and its shareholders to maintain a stable net asset value per share or a stable price per share, by virtue of either the amortized cost method of valuation or by use of the penny-rounding method of pricing, and that the money market fund will continue to use such method only so long as the board of directors believes that it fairly reflects the market-based net asset value per share; and either

(2) In the case of a money market fund using the amortized cost method of valuation:

(i) In supervising the money market fund's operations and delegating special responsibilities invloving portfolio management to the money market fund's investment adviser, the money market fund's board of directors (trustees) undertakes—as a particular responsibility within the overall duty of care owed to its shareholders—to establish procedures reasonably designed, taking into account current market conditions and the money market fund's investment objectives, to stabilize the money market fund's net asset value per share, as computed for the purpose of distribution, redemption and repurchase, at a single value;

(ii) Included within the procedures to be adopted by the board of directors (trustees) shall be the following:

(A) Procedures adopted whereby the extent of deviation, if any, of the current net asset value per share calculated using available market quotations (or an appropriate substitute which reflects current market conditions) from the money market fund's amortized cost price per share, will be determined at such intervals as the board of directors (trustees) deems appropiate and are reasonable in light of current market

conditions; periodic review by the board of directors (trustees) of the amount of the deviation as well as the methods used to calculate the deviation; and maintenance of records of the determination of deviation and the board's review thereof,

(B) In the event such deviation from the money market fund's amortized cost price per share exceeds ½ of 1 percent, a requirement that the board of directors (trustees) will promptly consider what action, if any, should be initiated by the board of directors (trustees), and

(C) Where the board of directors (trustees) believe the extent of any deviation from the money market fund's amortized cost price per share may result in material dilution or other unfair results to investors or existing shareholders, it shall take such action as it deems appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results;

(iii) The money market fund will maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value per share; *Provided, however,* That the money market fund will not: (A) Purchase any instrument with a remaining maturity of greater than one year, or (B) maintain a dollar-weighted average portfolio maturity which exceeds 120 days;

(iv) The money market fund will limit its portfolio investments, including repurchase agreements, to those United States dollars-denominated instruments which the board of directors (trustees) determines present minimal credit risks and which are of "high quality" as determined by any major rating service, or in the case of any instrument that is not rated, of comparable quality as determined by the board of directors (trustees);

(v) The money market fund will record, maintain, and preserve permanently in an easily accessible place a written copy of the procedures (and any modification thereto) described in paragraph (a)(2)(i) of this section and the money market fund will record, maintain, and preserve for a period of not less than six years (the first two years in an easily accessible place) a written record of the board of directors' (trustees) considerations and actions taken in connection with the discharge of its responsibilities, as set forth above, to be included in the minutes of the board of directors' (trustees') meetings. The documents preserved pursuant to this condition shall be subject to inspection by the Commission in accordance with section 31(b) of the Act [15 U.S.C.80a-30(b)] as if such documents were records required to be maintained pursuant to rules adopted under section 31(a) of the Act [15 U.S.C. 80a-30)]; and

(vi) If any action was taken pursuant to paragraph (a)(2)(ii)(C) of this section, the money market fund will file a statement as an attachment to Form N-1Q (filed pursuant to rule 30b1-1(b)) describing with specificity the nature and circumstances of such action within 30 days after the close of each calendar quarter during which such action was taken; or

(3) In the case of a money market fund using the penny-rounding method of pricing:

(i) In supervising the maney market fund's operations and delegating special responsibilities involving portfolio management to the money market fund's investment adviser, the money market fund's board of directors (trustees) undertakes—as a particular responsibility within the overall duty of care owed to its shareholders—to assure to the extent reasonably practicable, taking into account current market conditions affecting the money market fund's investment objectives, that the money market fund's price per share as computed for the purpose of distribution, redemption and repurchase, rounded to the nearest one per cent, will not deviate from the single price established by the board of directors (trustees).

(ii) The money market fund will maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable price per share; *Provided, however,* That the money market fund will not (A) purchase any instrument with a remaining maturity of more than one year, or (B) maintain a dollar-weighted average portfolio maturity which exceeds 120 days; and

(iii) The money market fund will limit its portfolio investments, including repurchase agreements, to those United States dollar-denominated instruments which the board of directors (trustees) determines present minimal credit risks, and which are of "high quality" as determined by any major rating service or, in the case of any instrument that is not rated, of comparable quality as determined by the board of directors (trustees).

(b) *Definitions.* (1) The "amortized cost method of valuation" is the method of calculating an investment company's current net asset value whereby portfolio securities are valued by reference to the fund's acquisition cost as adjusted for amortization of premium or accumulation of discount rather than by reference to their value based on current market factors.

(2) The "penny-rounding method of pricing" is the method of computing an investment company's price per share for purposes of distribution, redemption and repurchase whereby the current net asset value per share is rounded to the nearest one percent.

(3) A variable rate instrument is one whose terms provide for automatic establishment of a new interest rate on set dates.

(4) A floating rate instrument is one whose terms provide for automatic adjustment of its interest rate whenever some specified interest rate changes.

(5) The maturity of an instrument shall be deemed to be the period remaining until the date noted on the face of the instrument as the date on which the principal amount owed must be paid, or in the case of an instrument called for redemption, the date on which the redemption payment must be made, except that:

(i) If the board of directors (trustees) has determined that it is reasonable to expect that whenever a new interest rate on a variable rate instrument is established it will then cause the instrument to have a current market value which approximates it par value, (A) an instrument that is issued or guaranteed by the United States government or any agency thereof which has a variable rate of interest readjusted no less frequently than annually may be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate; (B) an instrument which has a demand feature that entitles the holder to receive the principal amount of such instrument from the issuer upon no more than seven days' notice and which has a variable rate of interest may be deemed to have a maturity equal to the longer of the period remaining until the interest rate will be readjusted or the period remaining until the principal amount owed can be recovered through demand, *Provided,* That the board of directors (trustees) determines no less frequently that quarterly that the instrument is of high quality; and (C) an instrument

which has a variable rate of interest may be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate, *Provided,* That the period remaining until the date noted on the face of the instrument as the date on which the principal amount owed must be paid is one year or less;

(ii) An instrument which has a demand feature that entitles the holder to receive the principal amount of such instrument from the issuer upon no more than seven days' notice and which has a floating rate of interest may be deemed to have a maturity equal to the period of time remaining until the principal amount owed can be recovered from the issuer through demand, *Provided,* That the floating interest rate is adjusted concurrently with any change in an identified market interest rate to which it is pegged and the board of directors (trustees) determines (A) that it is reasonable to expect that such floating rate feature will ensure that the market value of such instrument will always approximate its par value, and (B) no less frequently than quarterly that the instrument is of high quality;

(iii) A repurchase agreement may be treated as having a maturity equal to the period remaining until the date on which the repurchase of the underlying securities is scheduled to occur, or where no specific date is specified, but the agreement is subject to demand, the notice period applicable to a demand for the repurchase of the securities; and

(iv) A portfolio lending agreement may be treated as having a maturity equal to the period remaining until the date on which the loaned securities are scheduled to be returned, or where no specific date is specified, but the agreement is subject to demand, the notice period applicable to a demand for return of the loaned securities.

(6) "One year" shall mean 365 days except, in the case of an instrument that was originally issued as a one year instrument, but had up to 375 days until maturity, one year shall mean 375 days.

Statutory Basis: Rule 2a-7 is promulgated pursuant to the provisions of sections 6(c) (15 U.S.C. 80a-6(c)), 22(c) (15 U.S.C. 80a-22(c)) and 38(a) (15 U.S.C. 80a-37(a)) of the Act.

By the Commission.

July 11, 1983.

Shirley E. Hollis,

Assistant Secretary.

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DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Parts 101, 104, 201, and 204

[Docket No. RM83-61-000]

Technical Amendments to the Uniform Systems of Accounts for Public Utilities and Licensees and Natural Gas Companies

Issued March 29, 1983 and corrected by Erratum Notice issued May 13, 1983

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Technical amendments to correct errors.

SUMMARY: By these amendments, Parts 101, 104, 201, and 204 of Title 18 of the Code of Federal Regulations are amended to correct errors which have occurred in Title 18. The parts are further revised to delete the subtitle classifications from the textual section and to arrange the text of the accounts in a numerical sequence.

EFFECTIVE DATE: March 29, 1983.

ADDRESS: Office of the Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street NE., Washington, D.C. 20426.

FOR FURTHER INFORMATION CONTACT: Elaine Dawson, Office of Chief Accountant, Federal Energy Regulatory Comm., 825 North Capitol Street NE., Washington, D.C. 20426, (202) 376-9782. Jonas P. Green, Office of Chief Accountant, Federal Energy Regulatory Comm., 825 North Capitol Street NE., Washington, D.C. 20426, (202) 376-9624.

SUPPLEMENTARY INFORMATION: By these amendments, the Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act and the Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas Act, are amended to correct errors which have occurred in Title 18 of the Code of Federal Regulations. The accounts are further revised to delete the subtitle classifications from the textual section of the accounts and place the texts of the accounts in numerical sequence by account group.

A. Background and Summary

The Uniform System of Accounts Prescribed for Public Utilities and Licensees consists of (1) Part 101 for Class A and Class B Companies and (2) Part 104 for Class C and Class D Companies. The Uniform System of Accounts Prescribed for Natural Gas Companies consists of (1) Part 201 for Class A and Class B Natural Gas Companies and (2) Part 204 for Class C and Class D Natural Gas Companies.

Several errors have occurred in the Uniform Systems of Accounts in Title 18 CFR. Under these amendments, the Chart of Accounts to the Uniform Systems of Accounts is amended to correct those errors. The accounts are further revised to delete the subtitle classifications from the textual sections of the Accounts and to arrange the texts in a numerical sequence by account groups. These changes in the accounts as printed in the Code of Federal Regulations do not add or delete any required information, but rather correct errors in the Accounts as printed in the Regulations, and enhance the format in which the text of the accounts are printed in the Regulations, which will allow for easier reference, and lessen the possibility of confusion.

In consideration of the foregoing, Parts 101, 104, 201, and 204, Title 18 of the Code of Federal Regulations, are amended as set forth below.

Kenneth F. Plumb,

Secretary.

PART 101—[AMENDED]

1. Part 101 is amended in the section entitled, "Income Chart of Accounts," by adding two subtitle classifications under the classification, "2. Other Income and Deductions," and placing Account "420, Investment tax credits" immediately following Account "411.5, Investment tax credit adjustments, nonutility operations." As amended, the "Income Chart of Accounts" will read:

Income Chart of Accounts

* * * * *

2. Other Income and Deductions.

A. Other Income.

415 Revenues from merchandising, jobbing and contract work.

* * * * *

B. Other Income Deductions.

421.2 Loss on disposition of property.

* * * * *

C. Taxes Applicable to Other Income and Deductions.

408.2 Taxes other than income taxes, other income and deductions.

* * * * *

411.5 Investment tax credit adjustments, nonutility operations.

420 Investment tax credits.

Total taxes on other income and deductions.