The option contracts on the Robusta Coffee futures contract authorized for offer and sale in the United States by Order issued on November 30, 1989 was denominated in sterling. By letter dated January 30, 1991, and subsequent telephone conversations with Commission staff, London Fox advised the Commission that on or after March 1, 1991, the denomination for the option contract on the Robusta Coffee futures contract would be changed to United States dollars and that other terms and conditions of the contract would be changed as well. In addition, London Fox indicated that as of the changeover date, no new positions would be opened in sterling and that all new trading would be in dollars. Since the conversion to a dollar denomination is considered a material change in the option contract, the Commission is publishing the new terms and conditions of the option contract on the Robusta Coffee futures contract for notice purposes only.

Contract Specifications

Options on the Robusta Coffee Futures Contract

Contract Units: 5 tonnes.

Minimum Price Fluctuation: $1 per tonne.

Exercise/Strike Price Increments: $50 per tonne.

Trading Months: January, March, May, July, September, November.

Quoted Trading Months: Identical to the first seven quoted months on the underlying future.

Trading Hours: 09.45 to 12.32 hours; 14.30 to 17.00 hours. (As for the underlying Futures Contract—trading in Traded Options will continue until trading in the underlying Futures Contracts has ceased) Shall be the close of business on the third Wednesday in the preceding month. Declaration (or non-declaration) instruction shall be given to the Clearing House not later than one hour after close of business.

List of Subjects in 17 CFR Part 30

Commodity futures, Commodity options, Foreign commodity options.

Accordingly, 17 CFR part 30 is amended as set forth below:

PART 30—FOREIGN FUTURES AND FOREIGN OPTION TRANSACTIONS

1. The authority citation for part 30 continues to read as follows:

Authority: Secs. 2(a)(1)(A), 4, 4c, and 8a of the Commodity Exchange Act, 7 U.S.C. 2, 6, 6c and 12a.

2. Appendix B to part 30 is amended by revising the existing entry for "London Futures and Options Exchange" option contract on Robusta Coffee futures contract to read as follows:

Appendix B—Option Contracts Permitted To Be Offered or Sold in the U.S. Pursuant to Section 30.3(a)

Exchange	Type of contract	FR date and citation
* *	*	* *
London Futures and Options Exchange.	Option Contract on Robusta Coffee Futures Contract.	Dec. 6, 1989; 54 FR 50356. Feb. 27, 1991; 56 FR___.
* *	*	* *

Issued in Washington, DC on February 21, 1991.

Lynn K. Gilbert,

Deputy Secretary of the Commission.

[FR Doc. 91-4520 Filed 2-26-91; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230, 239, 270, and 274

[Rel. Nos. 33-6882; IC-18005; S7-13-90]
RIN 3235-AD91

Revisions to Rules Regulating Money Market Funds

AGENCY: Securities and Exchange Commission.

ACTION: Final amendments to rules and forms.

SUMMARY: The Commission is adopting amendments to rules and forms under the Securities Act of 1933 and the Investment Company Act of 1940 affecting money market funds. The amendments tighten the risk-limiting conditions of rule 2a-7, the rule that permits money market funds to use the amortized cost method of valuing portfolio securities and the penny-rounding method of computing price per share, and require that all mutual funds that hold themselves out as money market funds meet these conditions. The amendments require a money market fund to disclose prominently on the cover page of its prospectus and in its sales literature and advertisements that an investment in the fund is not guaranteed or insured by the U.S. Government and that there is no assurance that the fund will be able to maintain a stable net asset value. The amendments are designed both to reduce the likelihood that a money market fund will not be able to maintain a stable net asset value, and to increase investor awareness that investing in a money market fund is not without risk.

EFFECTIVE DATES: The amendments to rules 2a-7, 2a41-1, 12d3-1 and 34b-1 (17 CFR 270.2a-7, 270.2a41-1, 270.12d3-1 and 270.34b-1) and Form N-SAR (17 CFR 274.101) under the Investment Company Act of 1940 and rule 482 (17 CFR 230.482) under the Securities Act of 1933, and to Item 22 of Form N-1A (17 CFR 239.15A and 274.11A), Item 25 of Form N-3 (17 CFR 239.17a and 274.11b) and Item 21 of Form N-4 (17 CFR 239.17b and 274.11c) will be effective June 1, 1991. The amendments to Item 1 of Form N-1A and Item 1 of Form N-3 will be effective: (1) For investment companies whose registration statements become effective on or after May 1, 1991, and investment companies with fiscal years ending on December 31, as to prospectuses used on or after May 1, 1991; and (2) for all other investment companies, upon use of any prospectus contained in any post-effective amendment filed on or after May 1, 1991.

FOR FURTHER INFORMATION CONTACT: Kenneth J. Berman, Special Counsel, or Eli A. Nathans, Attorney, (202) 272-2107, Office of Disclosure and Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting several amendments to rules and forms affecting money market funds, including rule 2a-7 (17 CFR 270.2a-7) under the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*) ("1940 Act"). (Unless otherwise noted, all references to rule 2a-7, as amended, or any paragraph thereof, will be to 17 CFR 270.2a-7.) Rule 2a-7 is used by most money market funds to maintain a stable net asset value of $1.00 per share.

The Commission is adopting amendments to rule 2a-7 to require a money market fund to: (1) Limit its investment in the securities of any one issuer to no more than five percent of fund assets, measured at the time of purchase (the "five percent diversification test"), except for certain investments held for not more than three business days; (2) limit its investment in securities which are "Second Tier Securities" to no more than five percent of fund assets, with investment in the Second Tier Securities of any one issuer being limited to the greater of one percent of fund assets or one million dollars; and (3) limit investments to securities that are determined to have "minimal credit risks" and are "Eligible

Securities." "Eligible Securities" are defined as securities rated by the Requisite NRSROs in one of the two highest short-term rating categories and comparable unrated securities. "Second Tier Securities" are Eligible Securities that are not "First Tier Securities." "First Tier Securities" are defined as securities which are rated by at least two nationally recognized statistical rating organizations ("NRSROs") [1] or by the only NRSRO that has rated the security (the "Requisite NRSROs") in the highest short-term rating category, or comparable unrated securities.

The amendments also (1) Limit fund investments to securities with a remaining maturity of not more than thirteen months (except that money market funds that do not use the amortized cost method of valuation may invest in U.S. Government securities that have a remaining maturity of not more than twenty-five months); (2) require a fund to maintain a dollar-weighted average portfolio maturity of not more than ninety days; (3) require a fund, in the event that a portfolio security goes into default or the rating of a portfolio security is downgraded so that it is no longer an Eligible Security, and in certain other circumstances, to reassess promptly whether the security presents minimal credit risks, determine whether continuing to hold the security is in the best interest of the fund, and record such actions in fund records; and (4) require a fund to notify the Commission if it holds defaulted securities which amount to one-half of one percent or more of fund assets. Finally, the amendments to rule 2a–7 make it unlawful for any registered investment company to use the term "money market" in its name or hold itself out as a "money market fund" unless it meets the risk limiting conditions of the rule. Funds that hold themselves out as distributing income that is exempt from regular federal income tax ("tax exempt funds") are exempted from the five percent diversification test for First Tier Securities, the five percent limit on investments in Second Tier Securities and the one percent limit on investments in the Second Tier Securities of any one issuer.

The Commission is also adopting amendments to rule 482 (17 CFR 230.482) under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) ("1933 Act"), rule 34b–1 under the 1940 Act (17 CFR 270.34b–1), and Forms N–1A (17 CFR 274.11A and 239.15A), N–3 (17 CFR 274.11b and 239.17a), and N–4 (17 CFR 274.11c and 239.17b) under the 1933 and 1940 Acts to: (1) Require the cover page of money market fund prospectuses, and fund advertisements and sales literature, to disclose prominently that an investment in a money market fund is neither insured nor guaranteed by the U.S. Government and that there is no assurance that the fund will be able to maintain a stable per share net asset value; and (2) revise the definition of a "money market fund" for purposes of those funds eligible to quote a seven-day yield in advertisements and sales literature to include only those funds that meet the risk-limiting conditions.

Finally, the Commission is adopting amendments to rules 2a41–1 and 12d3–1 under the 1940 Act (17 CFR 270.2a41–1 and 270.12d3–1) and to instructions to Form N–SAR (17 CFR 274.101) to conform certain cross-references to specified paragraphs of rule 2a–7.

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I. Background

On July 17, 1990, the Commission proposed amendments to rules and forms under the 1933 Act and the 1940 Act affecting money market funds, including rule 2a–7 under the 1940 Act.[2] Rule 2a–7 permits money market funds to maintain a stable price per share,[3] through the use of the amortized cost method of valuation [4] and the penny-rounding method of pricing.[5] But for rule 2a–7, section 2(a)(41) of the 1940 Act (15 U.S.C. 80a–2(a)(41)), together with rules 2a–4 and 22c–1 under the 1940 Act (17 CFR 270.2a–4 and 270.22c–1), would require a money market fund to calculate its current net asset value per share by valuing portfolio securities for which market quotations are readily available at market value, and other securities and assets at fair value as determined in good faith by the board of directors ("mark-to-market").[6]

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[1] The term "nationally recognized statistical rating organization" is used in the Commission's uniform net captial rule (17 CFR 240.15c3–1(c)(2)(vi)(E), (F) and (H). The Commission's Division of Market Regulation responds to requests for NRSRO designation through no-action letters. Currently, the Division of Market Regulation has designated five NRSROs: Duff and Phelps, Inc. ("D&P"), Fitch Investors Services, Inc. ("Fitch"), Moody's Investors Service Inc. (Moody's"), Standard & Poor's Corp. ("S&P"), and, with respect to debt issued by banks, bank holding companies, United Kingdom building societies, broker-dealers and broker dealers' parent companies, and bank-supported debt, IBCA Limited and its affiliate, IBCA Inc. ("IBCA").

[2] Investment Company Act Rel. No. 17589 (July 17, 1990) (55 FR 30239 (July 25, 1990)) (the "Proposing Release"). Money market funds are open-end management investment companies investing in short-term debt instruments. There are currently 710 money market funds with over $536 billion in assets in approximately 21.3 million shareholder accounts. IBC/Donoghue's Money Fund Report, (Feb. 8, 1991) (the "Money Fund Report"). Data derived from the Money Fund Report is as of February 5, 1991. The information with respect to shareholder accounts is derived from the Investment Company Institute Mutual Fund Factbook 102 (30th ed. 1990). See the Proposing Release at nn. 3 through 7 and 15 through 18, and accompanying text, for a summary of the development of money market funds.

[3] Most money market funds maintain a stable price of $1.00 per share. The stable $1.00 price has encouraged investors to view money market funds as an alternative to bank deposit and checking accounts, even though money market funds lack federal deposit insurance.

[4] Under the amortized cost method, portfolio securities are valued by reference to their acquisition cost as adjusted for amortization of premium or accretion of discount. The definition of the term "amortized cost method" has been amended to substitute the term "accretion" for "accumulation" in order to reflect current finance and accounting terminology. Paragraph (a)(1) of rule 2a–7, as amended.

[5] Share price is determined under the penny rounding method by valuing securities at market value, fair value, or amortized cost (as described in note 6 and accompanying test, *infra*) and rounding the per share net asset value to the nearest cent on a share value of a dollar, as opposed to the nearest one tenth of one cent. Paragraph (a)(11) of rule 2a–7, as amended. See also Investment Company Act Rel. No. 13380 (July 11, 1983) (48 FR 32555 (July 18, 1983)) (hereinafter, "Release 13380") at n. 8, and Investment Company Act Rel. No. 12206 (Feb. 1, 1982) (47 FR 5428 (Feb. 5, 1982)) (hereinafter, "Release 12206") at n. 5.

[6] The Commission has adopted an interpretive position permitting open-end investment companies that hold a significant amount of debt securities to use the cost amortization method of valuation with respect to debt securities that mature in sixty days or less unless the particular circumstances dictate otherwise (*i.e.*, due to the impairment of the creditworthiness of an issuer). Investment Company Act Rel. No. 9786 (May 31, 1977) (42 FR 28999 (June 7, 1977)) (hereinafter, "Release 9786").

Rule 2a-7 was adopted in 1983.[7] It contains a number of conditions designed to reduce the likelihood that the net asset value of a money market fund as determined by the amortized cost method will deviate materially from its net asset value as determined by the mark-to-market method.[8] The rule also requires a fund's board of directors to take promptly such action as it deems appropriate to eliminate or reduce to the extent reasonably practicable any deviation between a fund's amortized cost and its mark-to-market value if the deviation could result in material dilution or unfair results to investors.[9] Currently, money market funds that rely on rule 2a-7 can invest only in "high quality" debt securities, *i.e.*, securities rated in one of the top two quality categories by any NRSRO.[10] Funds using the rule are prohibited from investing in instruments with a maturity of greater than one year and from maintaining a dollar-weighted average portfolio maturity that exceeds 120 days.[11] The rule's conditions have had the effect of maintaining the quality of securities held by money market funds, thus reducing the likelihood that a fund will hold securities that will substantially decline in value and that a fund will break a dollar.

As discussed in the Proposing Release, the Commission decided to reexamine the conditions contained in rule 2a-7 in light of developments in the commercial paper market since the rule was adopted.[12] In June 1989 and March 1990, several money market funds held commercial paper of issuers that defaulted. The shareholders of these money market funds were not adversely affected only because each fund's investment adviser (or an affiliate) purchased the defaulted paper from the fund at its amortized cost or principal amount.

The Commission proposed amendments to rule 2a-7 that would have required a money market fund to limit fund investments in securities that had received less than the highest rating from any NRSRO to five percent of fund assets (the "five percent quality test"). Investment in any single lower-rated issuer would have been limited to one percent of fund assets (the "one percent diversification test").[13] The amendments would have reduced the maximum permitted dollar-weighted average portfolio maturity to ninety days. The amendments would also have required money market funds to disclose to investors that investment in the fund is not federally insured or guaranteed. The proposal had two principal purposes: to provide additional safeguards to reduce the likelihood that a money market fund would have to break a dollar, and to increase investor awareness that investments in a money market fund are not "risk free."

The Commission received comments on the proposed amendments from 289 commenters, including sixty-nine issuers of commercial paper, eight commerical paper dealers and related trade groups, thirty-five investment companies (including the Investment Company Institute), three NRSROs, and 169 individual investors.[14] The comment letters reflect a wide variety of views on almost every topic discussed in the Proposing Release. Commenters representing the mutual fund industry generally supported most aspects of the Commission proposal, and in some cases would go further than the proposed amendments in restricting the types of securities in which money market funds may invest. Individual investors almost unanimously supported placing restrictions on money market fund investment in lowerated commercial paper. Issuers and commerical paper dealers almost uniformly opposed the proposed restrictions on purchases of securities that had not received the highest rating from a NRSRO.

Upon consideration of the comments and further analysis, the Commission is adopting the amendments with several changes, many of which were suggested by the commenters. The five percent diversification tests in being adopted substantially as proposed, with the proviso that a fund may invest more than five percent of its assets in the First Tier Securities of a single issuer for up to three business days after purchase in order to allow a fund more flexibility temporarily to invest large inflows of cash in a single high quality issuer. The one percent diversification and five percent quality tests for Second Tier Securities (collectively, the "Second Tier Security tests") have also been adopted substantially as proposed. However, the standards for determining which securities are subject to the Second Tier Security tests have been modified. Under the proposal, a security would have been a First Tier Security only if all NRSROs rating the security had given it the highest rating. Under the rule as amended, a security qualifies as a First Tier Security if two NRSROs (or one, if only one NRSRO has rated the security) (the "Requisite NRSROs") have given it the highest rating, or if it is an unrated security of comparable quality.[15] Where the Security is rated by only one NRSRO, or is unrated, the acquisition by the fund of the security must expressly be approved or ratified by the fund's board of directors. Tax exempt funds are exempted from the five percent diversification and the Second Tier Security tests.[16] The amendments also limit fund investments to securities with a remaining maturity of not more than thirteen months (except that a fund that does not use the amortized cost method may invest in U.S. Government securities with a remaining maturity of not more than twenty-five months), and require a fund to maintain a dollar-weighted average portfolio maturity of not more than ninety days. Finally, the amendments also make it unlawful for any registered investment company to use the term

[7] Rule 2a-7 was proposed in Release 12206, *supra* note 5, and adopted in Release 13380, *supra* note 5. Since its adoption, rule 2a-7 has been amended only once, in 1986, to permit money market funds to acquire put options and standby commitments. See Investment Company Act Rel. No. 14983 (Mar. 12, 1986) (51 FR 9773 (Mar. 21, 1986)) (hereinafter, "Release 14983").

[8] If the net asset value of a fund, as determined by the mark-to-market method of pricing, were to drop significantly below the net asset value as determined by the amortized cost method, investors who redeemed their investments would receive more than their *pro rata* share of the fund's assets, the interests of other shareholders would be diluted, and purchasing investors would pay too much for their shares.

[9] The board is required to consider promptly what action should be initiated where the deviation between the amortized cost and the mark-to-market value exceeds one half of one percent, including whether to reduce the share price to less than $1.00 ("breaking a dollar").

[10] The rule limits money market fund investment to these securities because they are subject to less credit risk than lower quality securities, and are therefore less likely to decrease in value while they are held by the fund.

[11] These conditions limit fund exposure to the risk that the quality of a security might decline over time or that market interest rates would rise, resulting in a decline in the value of the portfolio securities.

[12] See the Proposing Release, *supra* note 2, at nn. 15 through 20, and accompanying text.

[13] These securities were referred to in the Proposing Release as "Securities Not Having the Highest Rating." Rule 2a-7, as amended, refers to securities that are subject to the adopted investment limitations as "Second Tier Securities." While the basis for identifiying a Second Tier Security is somewhat different from the proposed test for Securities Not Having the Highest Rating, for ease of reference the term Second Tier Securities is also used in this Release to refer to securities that under the amendments as proposed would have been Securities Not Having the Highest Rating.

[14] The comment letters and a summary of the comments prepared by the Commission staff are included in File No. S7-13-90

[15] Corresponding changes have been made to the definition of "Eligible Securities" (which in the proposal, were referred to as "Eligible Quality" securities). *See* section II.B.3. of this Release, *infra*, and paragraph (a)(5) of rule 2a-7, as amended.

[16] However, a tax exempt fund may invest only in Eligible Securities. Paragraph (c)(3) of rule 2a-7, as amended.

"money market" in its name (or in the name of any of its redeemable securities) or hold itself out as a "money market fund" unless it meets the risk limiting conditions of the rule.

II. Discussion

A. Preliminary Matters

Rule 2a-7 limits a money market fund to investing in securities that its board of directors determines present "minimal credit risks" and that are "high quality" as defined in the rule.[17] While the amendments revise the definition of high quality, they do not revise the requirement that a money market funds' board of directors (or its delegate) evaluate the creditworthiness of the issuer of any portfolio security and any entity providing a credit enhancement for a portfolio security. Possession of a certain rating by a NRSRO is not a "safe harbor." Where the security is rated, having the requisite NRSRO rating is a necessary but not sufficient condition for investing in the security and cannot be the sole factor considered in determining whether a security has minimal credit risks. To underscore this point, a parenthetical has been added to the rule stating that the determination of whether an instrument presents minimal credit risks "must be based on factors pertaining to credit quality in addition to the rating assigned * * * by a NRSRO." [18]

The extensiveness of the evaluation will vary with the type and maturity of the security involved and the board's (or its delegate's) familiarity with the issuer of the security. For example, little credit analysis of a Government security would be expected. A different analysis may be appropriate for a security with a remaining maturity of seven days than for one of the same issuer with a remaining maturity of one year. In a letter dated May 8, 1990, the Division of Investment Management provided guidance on elements of a minimal credit risk analysis.[19] As stated in the May 8 Letter and reiterated in the Proposing Release, these elements are only examples. The focus of any minimal credit risk analysis must be on those elements that indicate the capacity of the issuer to meet its short-term debt obligations.

The amendments adopted in this Release place additional restrictions on money market funds in selecting portfolio securities, including commercial paper. The Commission believes these amendments are necessary to ensure that money market funds meet investors' expectations for safety, soundness and convenience by maximizing the likelihood that these funds will be able to maintain a stable net asset value under the pricing procedures they are permitted to use. Rule 2a-7 and the amendments adopted today were developed in response to the characteristics of a specific type of registered investment company with a specific type of share pricing standard. The Commission wishes to emphasize that the amendments are not intended to limit the ability of investment companies not holding themselves out as money market funds to invest in lower-rated securities, including lower-rated commercial paper. Nor are the amendments intended to suggest that these investment limitations are necessarily appropriate for any other types of investment vehicles.

B. Portfolio Quality and Diversification

1. Five Percent Diversification Test

Most money market funds taking advantage of the exemptions provided by rule 2a-7 are "diversified" investment companies within the meaning of section 5(b)(1) of the 1940 Act.[20] Section 5(b)(1) provides that a diversified investment company, with respect to seventy-five percent of its assets, may not invest more than five percent of its assets in securities of any issuer, other than cash, cash items, Government securities,[21] and securities of other investment companies.[22] The remaining twenty-five percent of the fund's assets (the "twenty-five percent basket") may be invested in any manner. The Commission proposed to amend rule 2a-7 to limit any money market fund (except a tax exempt fund) to investing no more than five percent of its total assets [23] in the securities—except Government securities—of any one issuer. The effect of this proposal would be to eliminate the twenty-five percent basket.

Most commenters, including most mutual fund commenters, supported the proposed five percent diversification test as appropriate for a money market fund and indicated that, despite the flexibility provided by section 5(b)(1) with respect to the twenty-five percent basket, in practice, most taxable money market funds limit their investment in non-U.S. Government issuers to approximately five percent or less of total assets. The Commission has decided to adopt the five percent diversification test as proposed, with a provision designed to permit funds to make certain temporary investments in excess of the five percent limit, and with the clarifications noted below.[24]

a. *Three Day Safe Harbor.* The five percent diversification test, as adopted, permits a fund to invest more than five percent of its total assets in the First Tier Securities of a single issuer for a period of up to three business days after the purchase thereof.[25] This change from the proposal has been made in response to commenters who asserted that the twenty-five percent basket often is useful in managing portfolio liquidity and large cash inflows; they urged that the ability to invest a large percentage of fund assets in a single high quality issuer on a temporary basis is an efficient way to assure liquidity in the event of unexpected redemptions by shareholders or to invest unanticipated cash inflows. The Commission believes that a three day limit will permit a fund to realize these efficiencies without being exposed to the risks asssociated

[17] The rule as originally adopted used the term "high quality." The Proposing Release used the term "Eligible Quality." Rule 2a-7, as amended, uses the term "Eligible Security." See note 15, *supra.*

The board generally can delegate to the fund's investment adviser the responsibility for determining that individual portfolio securities present minimal credit risks, but only under guidelines established by the board. In certain instances, these determinations must be expressly approved or ratified by the board (and not its delegate). See section II.F. of this Release, *infra.*

[18] Paragraph (c)(3) of rule 2a-7, as amended.

[19] Letter to Registrants (pub. avail. May 8, 1990) (hereinafter, the "May 8 Letter").

[20] 15 U.S.C. 80a-5(b)(1). Several tax exempt funds which concentrate in the obligations of state and local governments are not diversified within the meaning of section 5(b)(1). As discussed *infra,* the new diversification requirements of the rule are not being applied to tax exempt funds as this time. See paragraph (c)(4)(i) of rule 2a-7, as amended.

[21] The term "Government security" is defined in section 2(a)(16) of the 1940 Act (15 U.S.C. 80a-2(a)(16)). Paragraph (a)(8) of rule 2a-7, as amended, incorporates this definition.

[22] Section 5(b)(1) also prohibits diversified funds, with respect to seventy-five percent of their assets, from investing in securities that comprise more than 10% of the outstanding voting securities of an issuer.

[23] "Total Assets" is defined in paragraph (a)(18) of rule 2a-7, as amended, to mean, with respect to a fund using the amortized cost method, the total amortized cost of its assets, and with respect to any other money market fund, the total market-based value of its assets.

[24] Paragraph (c)(4)(i)(A) of rule 2a-7, as amended. For purposes of the diversification and quality tests, subsidiaries and parent companies are treated as separate issuers. In the case of banks having more than one branch, all branches are treated as the same issuer.

[25] *Id.* The term "business day" is defined in paragrpah (a)(2) of rule 2a-7, as amended, as any day other than a Saturday, Sunday or a customary national business holiday. Paragraph (c)(4)(i)(A) specifies that a fund may not make more than one investment within this safe harbor at any time.

with investing more than five percent of fund assets in a single issuer for an indefinite period of time. For example, a fund that holds First Tier Securities that will mature in three business days may avail itself of an opportunity to purchase additional securities of the same issuer rather than disposing of the securities it holds or waiting for them to mature. Funds which are diversified investment companies would still be subject to the diversification requirements of section 5(b)(1) of the 1940 Act, however, and the three day safe harbor could therefore be used only with respect to twenty-five percent of the net assets of the fund.

b. *Diversification as to Put Agreements.* Rule 2a-7 has been clarified to reflect the applicability of the five percent diversification test to puts. Except in the case of tax exempt funds, no more than five percent of a fund's assets may be invested in securities issued by or subject to puts from any single issuer.[26] However, an unconditional put is not subject to this test if no more than ten percent of the fund's total assets is invested in securities issued or guaranteed by the issuer of the unconditional put.[27]

c. *Diversification as to Bank Instruments.* The amended rule requires that a money market fund (except a tax exempt fund) not invest more than five percent of its assets in the securities of any one issuer. This limitation applies to investments in bank instruments that are "securities" under section 2(a)(36) of the 1940 Act (15 U.S.C. 80a-2(a)(36)). Bank instruments that are securities include time deposits (such as certificates of deposit), bankers' acceptances, letters of credit and similar instruments,[28] but do not include customary demand deposits.[29]

d. *Repurchase Agreements.* The proposed amendments provide that for purposes of the five percent diversification test, a repurchase agreement collateralized by Government securities would be deemed to be an acquisition of the underlying securities if it was "collateralized fully." [30] One commenter requested that the status of repurchase agreements collateralized by non-Government securities be clarified.

The rule, as adopted, extends the approach taken with respect to repurchase agreements collateralized by Government securities to other repurchase agreements.[31] After giving effect to the securities collateralizing the repurchase agreement, a fund may not invest more than five percent of its assets in any one issuer, including the issuer of securities collateralizing the repurchase agreement. Where the underlying securities are not Government securities, they also must be of the highest quality at the time the repurchase agreement is entered into, *i.e.*, rated in the highest grade by the "Requisite NRSROs." [32] This is to assure that in the event that the fund has to realize on the collateral, it will be holding only the highest quality securities. Fund directors should be aware of the risks of investing in repurchase agreements that are collateralized by instruments with remaining maturities of greater than one year. If the fund were required to realize on the collateral underlying the repurchase agreement, these instruments would have to be taken into account in calculating the fund's dollar-weighted average porfolio maturity. The fund would have to dispose of the collateral as soon as possible if the instruments constituting the collateral caused the fund's average portfolio maturity to exceed ninety days or did not satisfy the remaining maturity condition of the rule.[33]

2. Diversification and Quality Test for Second Tier Securities

The Commission proposed to prohibit a taxable money market fund from investing more than five percent of its total assets in Second Tier Securities,

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[26] Paragraph (c)(4)(ii) of rule 2a-7, as amended. Tax exempt funds would continue to be subject to the diversification requirement with respect to puts in the current rule, *i.e.*, the five percent diversification test for puts must be met with respect to seventy-five percent of the fund's assets. *Id.* However, the rule, as amended, makes clear that in determining compliance with this condition, the tax exempt fund must aggregate securities issued by and subject to puts from the same institution.

[27] Paragraph (c)(4)(iii)(C) of rule 2a-7, as amended. For purposes of rule 2a-7, unconditional puts are considered to be guarantees. Thus, rule 2a-7, as amended, treats unconditional puts and guarantees in the same manner as rule 5b-2 under the 1940 Act (17 CFR 270.5b-2). See the Proposing Release, *supra* note 2, at n. 31. An unconditional put includes a bank letter of credit or other unconditional credit enhancement under which the holder of the instrument subject to the put could recover amounts due on the instrument. Paragraph (a)(19) of rule 2(a)(7), as amended.

[28] See International Venture Finance, Ltd. (pub. avail. June 2, 1983) (certificates of deposit subject to federal deposit insurance are securities within the meaning of section 2(a)(36) of the 1940 Act). *Cf.* Investment Company Act Rel. No. 11421 (Oct. 31, 1980) (45 FR 73915 (Nov. 7, 1980)) (bank certificates of deposit and bankers' acceptances are among the types of securities excluded from the provisions of rule 17j-1 under the 1940 Act (17 CFR 270.17j-1)). See also note 24, *supra.*

[29] *Cf.* Section 6-04 of Regulation S-X (17 CFR 210.6-04) (demand deposits included as a "cash item" on investment company balance sheets).

[30] See the Proposing Release, *supra* note 2, at n. 30. A repurchase agreement may be regarded as a security issued by the entity promising to repurchase the underlying security at a later date. See Release 13380, *supra* note 5, at n. 28. The conditions that the Commission proposed for repurchase agreements collateralized by Government securities reflected prior pronouncements by the Commission and the Division of Investment Management. *Id.* See also Investment Company Act. Rel. No. 13005 (Feb. 2, 1983) (48 FR 5894 (Feb. 9, 1983)) (hereinafter, "Release 13005") in which the Division of Investment Management stated that a repurchase agreement entered into with a broker-dealer would not violate section 12(d)(3) of the 1940 Act (15 U.S.C. 80a-12(d)(3)) if it was "fully collateralized" and a fund board of directors had evaluated the creditworthiness of the broker-dealer with which it proposed to engage in a repurchase agreement transaction to determine that the broker-dealer did not present a serious risk of becoming involved in bankruptcy proceedings. As noted in Release 13005, a money market fund's board of directors (or its delegate) has a similar duty to evaluate creditworthiness of the broker-dealer or other institution that is party to the repurchase agreement under rule 2a-7 to assure that all securities purchased present minimal credit risks. See paragraph (c)(3) of rule 2a-7, as amended.

[31] Paragraph (c)(4)(i) of rule 2a-7, as amended, provides that for purposes of the five percent diversification test, the repurchase agreement is deemed an acquisition of the underlying securities provided that the agreement is "collateralized fully." Only that portion of the repurchase agreement which is collateralized fully would be subject to the special treatment discussed in this section. Any agreement or portion of an agreement which is not collateralized fully would be treated as an unsecured loan. As such, the loan itself would have to meet the quality requirements set out in the rule, the five percent diversification test, and, if applicable, the limitations placed on investment in Second Tier Securities. See Release 13380, *supra* note 5, at n. 31.

Paragraph (a)(3) of rule 2a-7, as amended, defines "collateralized fully." This definition has been adopted substantially as proposed. Certain duplicative language in the clause describing the requirements in connection with securities registered on a book entry system has been deleted from paragraph (a)(3)(ii). In order for a fund to retain the unqualified right to possess and sell the collateral, as required by paragraph (a)(3)(iii), its rights would have to be evidenced in an appropriate fashion. For example, in the case of U.S. Treasury bills, entry of the name of the fund or its custodian as owner on the book entry system maintained by a Federal Reserve Bank would evidence these rights. See 31 CFR 350.4.

[32] Paragraph (a)(3)(iv) of rule 2a-7, as amended. The "Requisite NRSRO" concept is discussed in section II.B.3. of this Release, *infra*. Repurchase agreements typically relate to long-term debt securities; the securities would have to be rated "AAA" or its equivalent. The rule does not require that the underlying securities comply with the provisions of the rule relating to remaining maturity; the maturity of the repurchase agreement is determined by reference to the date on which the underlying securities are required to be repurchased. See paragraph (d)(5) of rule 2a-7, as amended. Since any non-Government securities would have to be rated in the top grade, the question of the applicability of the Second Tier Security tests to the collateral does not arise.

[33] See Release 13380, *supra* note 5, at n. 29. Long-term instruments, including Government securities, expose a fund to greater interest rate risk than short-term instruments. See section II.C. of this Release, *infra.*

with investment in the Second Tier Securities of any one issuer being limited to no more than one percent of total assets.[34] In proposing these limitations the Commission stated that, in light of recent experiences of money market funds, a substantial investment in these securities may create an inappropriate risk for funds seeking to maintain a stable price per share. While most commenters representing the mutual fund industry supported or did not oppose these limitations on Second Tier Securities (or suggested additional limitations), all of the commercial paper dealers and issuers of Second Tier Securities that commented on the proposals strongly opposed them.[35]

Commenters opposing the proposal argued that these diversification and quality tests would raise the borrowing costs of second tier issuers by reducing the amount of their short-term paper bought by money market funds, and expressed concern that many funds, especially smaller funds, would not invest in any Second Tier Securities. Several of these commenters also argued that the Commission's concerns over the creditworthiness of second tier issuers were misplaced. These commenters urged the Commission to rely instead on increased prospectus disclosure concerning the risks posed when a money market fund invests in a substantial amount of Second Tier Securities. Many commenters also argued that the proposed limitations would discourage funds from performing independent credit research, since the benefits of research are often realized by investment in lower-rated securities that fund managers conclude have minimal credit risks. Commenters asserted also that the one percent diversification test would not permit a fund to make a sufficient investment in any one issuer of Second Tier Securities to justify the level of credit analysis that would be required to determine that the investment presented minimal credit risks. Commenters also noted that, because commercial paper is usually sold in minimum denominations of one million dollars, the one percent diversification test would preclude smaller money market funds from investing in Second Tier Securities.

In contrast, the Investment Company Institute ("ICI") and substantially all of the individual investor commenters urged the Commission to prohibit money market funds from investing in any Second Tier Securities.[36] The ICI argued that "past experience indicates that [Second Tier Securities] may undergo rapid deterioration and therefore may involve risks inappropriate for funds seeking to maintain a stable net asset value." Commenters favoring the Second Tier Security tests noted that a few funds with riskier investment policies breaking a dollar might lead to a loss of investor confidence in the entire money market industry. The ICI asserted that "in determining the quality standards for money market fund portfolio securities the exclusive focus must be on the protection of money market fund shareholders, who seek safety by investing in funds whose objective is the maintenance of a stable net asset value."

The Commission continues to believe that the recent history of defaults in the commercial paper market and the extent to which these defaults have affected funds warrant taking measures to assure that investors' expectations of the relative safety of investment companies holding themselves out as money market funds continue to be met. Almost all money market funds attempt to maintain a stable net asset value, and this policy is understood by investors to imply a high level of investor safety. Investors have come to equate investments in these funds to "money." Because holding money does not entail any credit risks, the credit risks to which holders of money market shares are exposed should be minimized to the lowest level practicable.[37]

After considering the comments received and after weighing the increased risks and benefits of allowing money market funds to invest a greater percentage of their assets in Second Tier Securities, the Commission has decided to adopt the Second Tier Security tests substantially as proposed, with one change to the one percent diversification test. As amended, rule 2a–7 limits money market fund investment in Second Tier Securities to no more than five percent of fund assets.[38] Paragraph (c)(4)(i)(B) of rule 2a–7, as amended, limits the amount a money market fund may invest in the Second Tier Securities of a single issuer to the greater of one percent of the fund's total assets or one million dollars. The alternative one million dollar test is intended to allow smaller money market funds to invest in Second Tier Securities.[39] The three day safe harbor discussed above applies only to First Tier Securities and thus it would not permit a fund to exceed the diversification limits for Second Tier Securities.

As explained in the Proposing Release, compliance with the five percent diversification and Second Tier Security tests is measured at the time the fund purchases the security. Thus a fund would not be required subsequently to dispose of a security because of a change in the percentage of fund assets the security represents or in the fund's overall investment in Second Tier Securities.[40] In addition, to facilitate determining compliance with the Second Tier Security tests, rule 2a–7, as amended, specifies that in calculating the percentage of fund assets invested in Second Tier Securities, a fund should only include securities that were Second Tier Securities at the time they were

[34] In each case compliance with the limitations would be determined at the time of acquisition.

[35] The proposed exemption of tax exempt funds from the five percent diversification and Second Tier Security tests was generally supported by commenters, who stated that these funds often would have difficulties meeting the tests due to the limited number of tax exempt issuers in certain markets. Paragraph (c)(4)(i) of rule 2a–7, as amended, adopts the exemption. The definition of tax exempt fund has been amended to clarify that it includes a fund that distributes income exempt from "regular" federal income tax. See paragraph (a)(17) of rule 2a–7, as amended. A fund that distributes income that is subject to the alternative minimum tax would therefore be considered a tax exempt fund for this purpose.

The Commission requested comment on the possibility of excluding money market funds aimed at institutional investers from the risk-limiting conditions of rule 2a–7. Comment was divided, and the Commission has decided not to create such an exemption at this time. The Commission is concerned that, if an institutional fund were to break a dollar, there might be a loss of confidence in the money market fund industry. An institutional investor exception is being considered in the Division of Investment Management's current study of the Investment Company Act. See Investment Company Act Rel. No. 17534 (June 15, 1990) (55 FR 25322 (June 21, 1990)).

[36] The ICI, however, urged the Commission to permit money market funds to invest up to ten percent of their assets in split rated paper (*i.e.*, paper that had received the highest rating from at least one NRSRO, but not from other NRSROs rating the paper), with investment in any split rated issuer being limited to three percent of fund assets. See discussion of the treatment of split rated paper in section II.B.3 of this Release, *infra*.

[37] In addition, these limitations are necessary in order to assure that shareholders of funds using the amortized cost of penny rounding method will not suffer any dilution of the value of their investment. See note 6, *supra*.

[38] Paragraph (c)(4)(i)(B)(*2*) of rule 2a–7, amended. Paragraph (a)(14) of rule 2a–7, as amended, defines a Second Tier Security as any Eligible Security that is not a "First Tier Security." Paragraph (a)(8) of rule 2a–7, as amended, defines a First Tier Security as a security that is rated by the "Requisite NRSROs" in the highest rating category, or if unrated, which is of comparable quality. See, section II.B.3 of this Release, *infra*, discussing the definition of the term "Requisite NRSROs," and its effect on split rated securities.

[39] The five percent diversification and five percent quality tests would still apply, and thus a fund could not purchase one million dollars of Second Tier Securities if it would result, immediately after the purchase of the securities, in the fund having more than five percent of its total assets invested either in securities of that issuer or in Second Tier Securities.

[40] Paragraph (c)(4)(i) of rule 2a–7, as amended.

acquired (at original purchase or at any subsequent roll-over) and need not take into account rating changes subsequent to the acquisition of the security.[41]

3. Treatment of Split Rated Securities

This section (insofar as it discusses the term "Eligible Security") and all subsequent sections of the Release describe changes that are applicable to both taxable and tax exempt funds.[42]

Currently, rule 2a-7 permits a money market fund to purchase a security as long as at least one NRSRO rates it within the top two categories of its rating system. Some securities have different ratings from different NRSROs (*i.e.*, "split ratings"). Split ratings may result from the failure of one NRSRO to perceive quality problems or improvements perceived by another NRSRO, or may reflect differences among NRSROs as to the emphasis placed on different criteria. Under the proposed amendments, the relative quality of a security would have been determined by reference to the rating received from each NRSRO rating the security and a split rated security would be treated as having the lower rating. The lower rating would have determined whether a fund could purchase the securities and whether they would be subject to the Second Tier Security tests.

Many commenters, including those supporting the principal elements of the proposals, argued that this approach would give too much influence to a single NRSRO, which effectively could veto the ratings of all other NRSROs. Many mutual fund commenters also complained about the expense and burden of keeping current as to ratings of all of the NRSROs.

Commenters suggested a number of alternatives. In response to the comments, the Commission has decided to adopt an approach suggested by the ICI and several other commenters. Under this approach, a security would be an Eligible Security, and either a First Tier or Second Tier Security, if the "Requisite NRSROs" have agreed on the relevant rating.[43] In the case of a security that has been rated by only one NRSRO, that rating determines the status of the security during the time it is held by a money market fund.[44] However, the acquisition of a security rated by only one NRSRO must be approved or ratified by the fund's board of directors.[45] If a security has been rated by more than one NRSRO, it must have received the requisite rating from at least two NRSROs.[46] Thus, if a security has received the highest rating from two NRSROs, it is a First Tier Security even if other NRSROs have given it a lower rating.

The adopted approach to split rated securities relies on the agreement of at least two NRSROs rather than unanimity of all the NRSROs that have rated the security. It will preclude a security from being a First Tier Security based on the opinion of only one NRSRO when other NRSROs have given it less than the highest rating. Conversely, it will preclude a single NRSRO from preventing a security from being an Eligible Security or a First Tier Security in the face of a consensus of at least two other NRSROs. Finally, where a security has received the applicable ratings from the Requisite NRSROs, a fund will not be required to monitor the actions of all the NRSROs unless the security has been rated by only one NRSRO.[47] A money market fund could limit the number of NRSROs it must follow by adopting a policy of only investing in securities rated by at least two NRSROs [48]

C. Maturity of Portfolio Securities

1. Ninety-Day Dollar Weighted Average Maturity

The Commission is adopting proposed rule amendments to require a money market fund to maintain a dollar weighted average portfolio maturity of not more than ninety days, as opposed to the 120 days now permitted.[49] The change will decrease the exposure of money market fund investors to interest rate risk.

Most commenters supported the change. These commenters stated that almost all funds already limit their maturities to an even greater extent than the amendments would require.[50] As explained in the Proposing Release, the ninety-day limit is a maximum.[51] A

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[41] Thus, a fund would not be required to "drop" a First Tier Security into the five percent Second Tier Security "basket" due to a downgrade. Paragraph (c)(4)(i)(B) of rule 2a-7, as amended. However, a fund board of directors (or its delegate) will be required to assess promptly whether a security which has ceased to be a First Tier Security presents minimal credit risks and cause the fund to take such action as is determined to be in the best interest of the fund. See note 70 and accompanying text, *infra*, and paragraph (c)(5)(i) of rule 2a-7, as amended. If the security is no longer a Second Tier Security because of a rating downgrade, it must be disposed of unless the board of directors determines that holding it is in the fund's best interest. *See* section II.E.1 of this Release, *infra*, and paragraph (c)(5)(ii) of rule 2a-7, as amended.

[42] While tax exempt funds are not subject to the Five Percent Diversification and Second Tier Security tests, they are, like taxable funds, only permitted to invest in Eligible Securities. See paragraph (c)(3) of rule 2a-7, as amended, and notes 15 and 16 and accompanying text, *supra*.

[43] Paragraphs (a)(5)(i), (a)(6), (a)(13) and (a)(14) of rule 2a-7, as amended. Rule 2a-7, as amended, reflects the fact that some NRSROs rate specific security issues while others provide a rating of the issuer that is applicable to all of the issuer's debt within a specific class (*e.g.*, short-term or long-term). This approach is also reflected in the definition of "Unrated Securities." See section II.D. of this Release and paragraph (a)(20) of rule 2a-7, as amended.

[44] Paragraph (a)(13) of rule 2a-7, as amended, defines the term "Requisite NRSROs." Where a security is rated by only one NRSRO, neither a money market fund nor the issuer is required to solicit ratings from other NRSROs to make the security eligible for investment by the fund. In addition, where only one NRSRO has issued a rating with respect to the security at the time it is purchased or rolled over, under paragraph (a)(13) that NRSRO determines the status of the security regardless of any subsequent ratings by other NRSROs. If a security is rated by only one NRSRO when purchased, a change in the security's status (*i.e.*, from First Tier to Second Tier) will trigger the reassessment requirement only when the NRSRO that rated the security when it was originally acquired lowers its rating. However, where the security is a Second Tier Security, a reassessment of its credit risk by the fund's board of directors would be required if the fund's investment adviser becomes aware that any other NRSRO subsequently rated the security below its second highest rating. See section II.E. of this Release, *infra*.

[45] Paragraphs (c)(3) and (e) of rule 2a-7, as amended.

[46] *Id.* Paragraph (a)(6) of rule 2a-7, as amended. Similarly if at least two NRSROs have rated the security in one of their two highest rating categories for short-term debt obligations, the security is an Eligible Security. Paragraph (a)(5) of rule 2a-7, as amended.

[47] A money market fund will have to determine whether any other NRSRO has rated a security that, when purchased, was rated by only one NRSRO, in two situations: (1) when it proposes to buy that security, to confirm that it is not rated by other NRSROs; and (2) when it proposes to "roll over" that security to determine whether another NRSRO has given it a lower rating. See note 44, *supra*, and paragraph (a)(13) of rule 2a-7, as amended. However, a reassessment of the security's credit risk would be required if the investment adviser becomes aware that a NRSRO has given the security less than its second highest rating. See section II.E. of the Release, *infra*.

[48] Currently the Commission's Division of Market Regulation has designated five NRSROs. See note 1, *supra*.

[49] Paragraph (c)(2)(iii) of rule 2a-7, as amended.

[50] As of February 5, 1991 the average portfolio maturity of taxable money market funds was 53 days and the average maturity of tax exempt funds was 50 days. See the Money Fund Report, *supra*, note 2. One commenter noted that the danger that a long portfolio maturity might cause a fund to break a dollar has been demonstrated. In 1987, municipal money market instruments fluctuated by 240 basis points over a sixty day period, a fluctuation large enough to cause a fund with a ninety-day average dollar weighted average maturity to break a dollar. The commenter suggested that the maximum portfolio maturity be reduced to sixty days. However, the Commission believes that a ninety day period should provide money market fund investors with additional safeguards without unduly limiting the flexibility of money market funds to adjust fund maturities to levels that are appropriate in view of market conditions.

[51] See the Proposing Release, *supra* note 2, at n. 61.

money market fund must maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value or price per share.[52] Thus, in delegating portfolio management responsibilities to the fund's investment adviser, the board should adopt guidelines with respect to portfolio maturity designed to assure that this objective is met.

2. Extension of Maximum Maturity Period for Any Security

The proposed amendments would have extended the current limit on the maximum remaining maturity of any portfolio security from one year [53] to two years. Most commenters addressing this issue criticized this proposal as inconsistent with other changes proposed by the Commission. Commenters stated that a two-year maximum would increase the exposure of funds to both credit risk and interest rate risk. One commenter supported the proposed extension, arguing that, in the context of the ninety-day average limit, increasing maximum allowed maturities would have little effect on the overall risk exposure of a fund while allowing it to enhance yield. Several commenters stated that if the Commission was concerned by the degree of risk involved in increasing the permitted maturity period of securities, it could limit purchases of longer maturity instruments to Government securities. In view of the increased credit risks of securities with longer maturities, the Commission has decided to limit investment in securities with longer maturities to Government securities.[54] However, since the value of Government securities with a remaining maturity in excess of thirteen months may be subject to price fluctuations due to changes in interest rates (which could result in significant deviations between amortized cost and market values), rule 2a–7, as amended, permits their purchase only by a money market fund that uses market-based values in calculating its net asset value (including funds that rely on Release 9786 to value portfolio securities.[55]

With respect to securities other than Government securities, as suggested by several commenters, the rule extends the maximum permitted maturity of individual securities to thirteen months. This change has been made in order to accommodate funds purchasing annual tender bonds, and securities on a when-issued or delayed delivery basis. These securities often are not delivered for a period of up to one month after the purchaser has made a commitment to purchase them. Since the purchaser must "book" the security on the day it agrees to purchase it, the maturity period begins on that day.[56] The revised rule allows funds to invest in securities with a remaining maturity of no more than thirteen months (397 days).[57]

3. Variable Rate Demand Instruments

Many commenters objected to the provision of the current rule that the remaining maturity of a variable rate instrument with a demand feature be deemed equal to the longer of (i) the period remaining until the next interest readjustment or (ii) the period remaining until the principal amount can be recovered through demand. Several commenters urged the Commission to revise the standard to provide that the maturity period is the shorter of the two periods. One commenter recommended that the maturity period simply be made equal to the period remaining until the next interest readjustment, ignoring any demand feature.

The current treatment of variable rate instruments derives from a concern that measuring maturity only from interest rate readjustments does not reflect the risk that the quality of a variable rate instrument might decline.[58] Therefore, retaining the current approach continues to be appropriate generally.[59]

D. Unrated Securities, Long-term Securities and Demand Instruments

Rule 2a–7 permits a fund to invest in unrated securities that the board of directors deems to be of comparable quality to instruments that are "Eligible Securities" by virtue of the ratings assigned them.[60] The Commission has modified the rule to clarify that a security that is not itself rated is not an Unrated Security if its issuer has received ratings for outstanding securities that are comparable in priority and security with the security.[61] In response to commenter suggestions that the lack of a rating often indicates that a security would not have received the first or second highest rating from any NRSRO, paragraph (c) of rule 2a–7, as amended, requires that the fund's board of directors approve or ratify the acquisition of each unrated security.[62]

Currently, securities with one of the two highest long-term ratings are considered "high quality" securities.[63] Thus, where long-term ratings are used to determine whether securities are "high quality," money market funds may only invest in securities rated "AA" (or its equivalent) and above.[64]

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[52] See paragraph (c)(2) of rule 2a–7, as amended.

[53] The current rule defines one year as 365 days, but provides that in the case of an instrument that was issued as a one year instrument, but has up to 375 days until maturity, one year means 375 days. This provision was designed to accommodate certain government agency securities that have this characteristic. See Release 13380, *supra* note 5, at n. 13.

[54] Paragraph (c)(2) of rule 2a–7, as amended. In order to accommodate Government securities purchased on a delayed delivery or when issued basis as discussed *infra*, paragraph (c)(2)(ii) provides that a fund not using the amortized cost method may invest in a Government security with a remaining maturity of 762 calendar days (25 months). In addition, funds may invest in Government securities that have final maturities in excess of twenty-five months provided that the interest rate is adjusted at least every twenty-five months. See paragraph (d)(1) of rule 2a–7, as amended.

[55] See note 6, *supra*.

[56] The remaining maturity of an instrument is measured from the trade date or such other date upon which the fund's interest in the security is subject to market action. See Release 13380, *supra* note 5, at n. 11. At the suggestion of one commenter, this language has been incorporated into the rule at paragraph (d). 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" or "delayed delivery" securities, if the commitment to purchase is based upon either a set price or yield, then the maturity will be calculated based upon the commitment date. *Id.*

[57] Paragraph (c)(2)(i) of rule 2a–7, as amended.

[58] See Release 13380, *supra* note 5, at n. 27. The Commission also believed that variable rate demand notes might not be readily marketable. The term "Variable Rate Instrument" is defined in paragraph (a)(21) or rule 2a–7, as amended.

[59] Paragraph (d)(2) of rule 2a–7, as amended.

[60] Paragraph (c)(3) of rule 2a–7, as amended. The definition of Eligible Security includes certain unrated securities. See paragraph (a)(5)(iii) of rule 2a–7, as amended.

[61] Paragraph (a)(20) of rule 2a–7, as amended, excludes from the definition of "Unrated Security" those securities issued by an issuer that has a rating with respect to a comparable class of short-term debt obligations (or a security within that class). Therefore, such a security would, under paragraphs (a)(5) (i) and (ii) and (a)(6) of the rule, be a rated security and would be an Eligible Security or First Tier Security only if the comparable class of securities (or the issuer with respect to a comparable class) received from the Requisite NRSROs a Short-term rating in one of the two highest categories (or, in the case of a First Tier Security, the highest category).

[62] Paragraphs (c)(3) (second sentence) and (e) of rule 2a–7, as amended. See note 78 and accompanying text, *infra*, for a discussion of approval and ratification procedures. Government securities, which are generally unrated, are excluded from this provision.

[63] "Short-term" is defined to mean a remaining maturity of 366 days or less and "Long-term" is defined to mean a remaining maturity greater than 366 days. Paragraphs (a)(15) and (a)(9), respectively, of rule 2a–7, as amended. This corresponds to the categorization of debt instruments used by the NRSROs. Thus, an "intermediate-term" note with a remaining maturity of two years is treated as long-term debt.

[64] Under the current rule, funds must determine that an instrument with a conditional demand feature (or its issuer) has a "high quality" long-term rating. See paragraphs (a)(2)(iv) and (a)(3)(iii) of rule 2a–7, as currently in effect (17 CFR 270.2a–7(a)(2)(iv) and 270.2a–7(a)(3)(iii)). In addition, if a security with

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Commenters recommended that the Commission permit funds to purchase long-term securities with one of the three highest ratings, *i.e.*, those rated "A" or above. Several commenters stated that most issuers with long-term ratings in the three highest categories are rated in the highest short-term category, and the remainder are rated in the second highest category.

The Commission agrees that the correct yardstick of quality is the rating given to the issuer's short-term debt, since at the time a money market fund invests in a long-term security, its remaining maturity will be less than thirteen months.[65] Where the issuer has rated short-term debt outstanding that is now comparable in terms of priority and security to the long-term security, the fund must base its determination of whether the long-term security is an Eligible Security or a First Tier Security on the short-term rating, regardless of the long-term rating.[66] The Commission is not convinced that issuers with a single "A" long-term rating, but no short-term rating, will in all cases be appropriate investments for money market funds. Where the issuer does not have rated short-term debt outstanding, the long-term security is treated as unrated,[67] but may not be purchased if it has a long-term rating from any NRSRO that is below the second highest category.[68]

The amendments, as adopted, also clarify the categorization of demand instruments as Eligible Securities and First Tier Securities.[69] As under the current rule, a demand instrument that has an Unconditional Demand Feature may be determined to be an Eligible Security or a First Tier Security based solely on whether the Unconditional Demand Feature is an Eligible Security or a First Tier Security, as the case may be. Where the demand instrument does not have an Unconditional Demand Feature, in addition to having the requisite short-term ratings, the long-term debt securities of the issuer of the demand instrument (or the demand instrument itself) must be rated by the Requisite NRSROs in one of the two highest rating categories for long-term debt obligations, or, if unrated, determined to be of comparable quality by the money market fund's board of directors.

E. Changes in Credit Risk and Quality

1. Disposition of Portfolio Securities

The Commission proposed to require that where a money market fund holds a security that is in default, is no longer "Eligible Quality," or no longer presents "minimal credit risks," the fund must dispose of the security "as soon as practicable" absent a specific finding by the board that this would not be in the best interests of the fund. In the event securities were downgraded by a NRSRO but remained "Eligible Quality" securities, a prompt reassessment would have to be made as to whether the security presents minimal credit risks. The Commission is adopting these requirements, modified as discussed below.

As amended, the rule requires a prompt reassessment in two circumstances. First, a reassessment is required by the board of directors (or its delegate) where a security ceases to be a First Tier Security, either because it no longer has the highest rating from the Requisite NRSROs or, if unrated, is not deemed to be of comparable quality to a First Tier Security.[70] Second, a reassessment is required where the fund's investment adviser becomes aware that any NRSRO has rated a Second Tier Security or an Unrated Security below its second highest rating.[71] This reassessment must be undertaken promptly by the board and not its delegate.[72] This requirement to reassess a security that receives less than the second highest rating from any NRSRO has been added to assure that a money market fund will remain sensitive to, and take appropriate action in response to, perceived changes in the credit quality of Second Tier and Unrated Securities after they have been acquired by the fund. However, the rule provides that a reassessment by the board of directors is not required if, in accordance with the procedures adopted by the board of directors, the security is disposed of (or matures) within five business days of the adviser becoming aware of the new rating, provided the board is subsequently notified of the adviser's actions.

The amendment requiring that defaulted securities or securities that are no longer Eligible Securities be disposed of, absent certain determinations, has been adopted substantially as proposed. Several commenters suggested that the proposed amendment could be interpreted as requiring the fund to dispose of a defaulted securities or a security that is no longer an Eligible Security in a "fire sale" environment that would not be in the best interest of the fund. The Commission would expect the board to take market conditions into account in determining whether to continue to hold a defaulted security or a security that is no longer Eligible Quality in its portfolio.[73] To clarify this, paragraph (c)(5)(ii) of rule 2a-7, as amended, specifies that in determining that disposing of a security would not be in the best interest of the fund, the board may take into account "among other

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a remaining maturity of one year or less has a long-term rating, it must be "high quality" for the security to be eligible for fund investment. See Release 13380, *supra* note 5, at n. 34.

[66] As discussed *infra*, rule 2a-7, as amended, contains specific provisions for categorizing an instrument whose remaining maturity is determined by reference to a demand feature.

[66] Similarly, where the issuer has a short-term rating, the fund must rely on that rating. See paragraphs (a)(5)(ii) and (a)(6) of rule 2a-7, as amended.

[67] Paragraph (a)(20)(ii) of rule 2a-7, as amended, defining the term "Unrated Security."

[68] Paragraph (a)(5) of rule 2a-7, as amended. This provision is designed to provide an independent check on a fund's quality determination. See Release 13380, *supra*, note 5, at n. 34.

[69] As proposed, these provisions appeared in the definition of "Eligible Quality." They now appear in paragraphs (c)(3) (i) and (ii) of rule 2a-7, as amended.

[70] One commenter requested clarification that, if a security were downgraded from a First Tier Security to a Second Tier Security, but the fund's holding of the security did not exceed the quality and diversification limits for Second Tier Securities, prompt reassessment on the part of the fund would not be required. The rule is being clarified, but not in the direction urged by the commenter. The rule, as amended, requires that if a security ceases to be a First Tier Security, a reassessment is required. Similarly, if one of the Requisite NRSROs indicates that it is reconsidering an issuer's rating, a fund may wish to consider reassessing the security's credit risks, although the fact that a security's rating is being reconsidered would not constitute a rating downgrade for purposes of the rule.

Where a First Tier Security is rated by only one NRSRO when acquired, but is subsequently given lower ratings by other NRSROs, it would continue to be a First Tier Security, and no reassessment would be required by the rule. See note 44, *supra*, and accompanying text. However, for purposes of acquiring an additional position in the security or, upon maturity, rolling it over, the security would not be a First Tier Security. If the NRSRO that had rated the security at the time it was required reduces its rating, a reassessment is required and, if it is no longer an Eligible Security, it must be disposed of as soon as practicable. See paragraphs (c)(5)(i) and (c)(5)(ii) of rule 2a-7, as amended.

Clarification was also requested as to whether the downgrading of other securities of an issuer would prompt the reexamination requirement. The rule does not require reexamination of the security held by the fund in this circumstance, except where the categorization of a portfolio security as an Eligible Security or a First Tier Security was based on the rating of the down-graded security. Paragraph (c)(5) of rule 2a-7, as amended.

[71] The rule does not require, and the Commission does not expect, investment advisers to subscribe to every rating service publication in order to comply with this requirement. The Commission would expect an investment adviser to become aware of a subsequent rating if it is reported in the national financial press or in publications to which the adviser subscribes.

[72] Paragraph (e) of rule 2a-7, as amended. A telephonic board of directors meeting could be promptly convened to discuss the security.

[73] The decision to hold the security would have to actually be made by the board, and not its delegate. See section II.F. of this Release, *infra*.

factors, market conditions that could affect the orderly disposition of the security." In addition, the rule now specifies that, where the board has not determined that holding the security is in the best interest of the fund, it must be sold "as soon as practicable consistent with achieving an orderly disposition of the security." [74]

2. Commission Notification

The Commission is adopting the proposed requirement that a money market fund holding one or more defaulted portfolio securities that, immediately before the default, accounted for one half of one percent or more of fund assets, promptly notify the Commission of this fact and of the action the fund intends to take. At the request of several commenters, the paragraph, as adopted, does not require that the Commission be notified in the event of an "immaterial default unrelated to the financial condition of the issuer." This is intended to avoid Commission notification where the default is technical in nature, such as where the obligor has failed to provide a required notice or information on a timely basis.[75]

3. Reporting Requirements

The Commission also proposed to require funds to report on Form N-SAR actions taken in connection with defaults of portfolio securities, changes in credit quality or a deviation of the net asset value of the portfolio from market value. In response to comments that such reporting would be of little value and might inhibit board deliberations, the Commission has limited this requirement to reporting actions that were taken with respect to defaulted securities held during the period covered by the report and identifying securities held on the last day of the period covered by the report that are no longer Eligible Securities.[76] Information concerning the determination by a fund board that a portfolio security no longer represents a minimal credit risk would not have to be reported on Form N-SAR.

F. Portfolio Management Responsibilities

On several occasions the Commission has stated that the portfolio management requirements imposed by rule 2a-7 may be delegated by the board of directors to the fund's investment adviser, provided that the board retains sufficient oversight.[77] In response to commenter concern over the scope of the board's responsibility, new paragraph (e) of rule 2a-7 clarifies the responsibilities of the board to guide and monitor the investment adviser when the board delegates responsibilities for portfolio determinations. The paragraph states that the board may delegate to the investment adviser or an officer of the fund all of the responsibilities it has under the rule other than the determination that the fund should maintain a stable net asset value (paragraph (c)(1)), the establishment of amortized cost method procedures to achieve this objective (paragraphs (c)(6)(i) and (c)(6)(ii)), certain determinations with respect to Second Tier Securities, Unrated Securities, and certain securities that have been downgraded by NRSROs (paragraphs (c)(5)(i)(B) and (c)(5)(ii)), and in connection with the pennyrounding method of pricing, and duty to supervise the delegate (paragraph (c)(7)). In addition, credit risk determinations with respect to Unrated Securities and securities that have been rated by only one NRSRO must be approved or ratified by the fund's board of directors.[78] The requirements of paragraph (e) are substantially consistent with previously stated Commission positions concerning the circumstances under which the board may delegate its responsibilities.[79]

G. Investment Companies Holding Themselves Out as Money Market Funds

The Commission is adopting, substantially as proposed, a new paragraph (b) to rule 2a-7 to make it unlawful for a registered investment company to (1) adopt "money market" or similar terms as part of its name or title, or the name or title of any redeemable security of which it is the issuer, or (2) hold itself out to investors as a money market fund, or the equivalent of a money market fund, unless the company meets the risk-limiting conditions of paragraphs (c)(2) (maturity), (c)(3) (quality) and (c)(4) (diversification) of rule 2a-7, as amended.[80]

A fund that determines not to comply with the risk-limiting conditions of rule 2a-7, as amended, will be required to change its name to the extent it includes the term "money market" or similar terms.[81] Pursuant to paragraph (b) of the rule, as amended, a fund which invests in short-term instruments but which does not wish to hold itself out as a money market fund may call itself any name that would accurately convey its character without being misleading.[82]

One commenter argued that the Commission lacked rulemaking authority under section 38(a) of the Act (15 U.S.C. 80a-37(a)) to adopt paragraph (b). The Commission disagrees. Section 34(b) of the Act makes it unlawful for any person to make any untrue statement of a material fact in any document filed with the Commission or transmitted pursuant to the Act, or the keeping of which is required by section 31(a) of the Act (15 U.S.C. 80a-30(a)), or to omit to state any fact necessary in order to prevent the statements made therein, in light of the circumstances under which they were made, from being materially misleading. Through

[74] *Id.*

[75] Similar changes have been made in paragraph (c)(5)(ii)(A) of rule 2a-7, as amended, which requires that certain actions be taken in the event of a default. The Commission is not adopting the suggestion of several commenters that the notice requirement be limited to payment defaults. Certain non-payment defaults, such as a breach of a net worth covenant, could cause the value of a security to deviate materially from its amortized cost.

[76] Paragraph (c)(8) of rule 2a-7, as amended. Conforming changes have been made to the instructions to Item 77N of Form N-SAR.

[77] See, *e.g.*, Release 13380, *supra* note 5, and the Proposing Release, *supra* note 2.

[78] Paragraph (c)(3) of rule 2a-7, as amended. It would not be necessary to convene the board of directors every time the fund acquires such a security. The board of directors could establish an approved list of securities, provided that it periodically makes the requisite credit risk determinations with respect to the securities on the list. In addition, the adviser could acquire a security in accordance with guidelines established by the board, but the board would have to ratify the acquisition at its next meeting.

[79] *Id.* Written copies of the guidelines established by the board in delegating portfolio management responsibilities must be maintained by the fund. Paragraph (c)(8) of rule 2a-7, as amended.

[80] An investment company holding itself out as a money market fund would not be required to use the amortized cost method of valuation or the penny-rounding method of pricing. Nor would the rule require a fund that does not meet the risk-limiting conditions of the rule to change its investment policies. The rule would only require such a fund to meet the risk-limiting conditions of the rule if it continues to hold itself out as a money market fund.

The prohibition on using the term "money market" in the name of a security has been limited to redeemable securities. Paragraph (b) of rule 2a-7, as amended. The term "redeemable security" is defined in section 2(a)(32) of the 1940 Act (15 U.S.C. 80a-2(a)(32)).

[81] See paragraph (b) of rule 2a-7, as amended, and the Proposing Release, *supra* note 2, at n. 65.

[82] The rule amendments adopt a significantly more restrictive view of the term money market fund than currently permitted by Guide 1 to Form N-1A, which states that if a registrant has a name indicating that it is a money market fund, it should have investment policies requiring investment of at least 80% of its assets in debt securities maturing in thirteen months or less. The Commission does not believe that funds previously relying on the staff guideline have misled investors. However, the Division of Investment Management is withdrawing this portion of Guide 1 effective on the date the amendments to rule 2a-7 become effective.

sections 9(b) and 42 (15 U.S.C. 80a–9(b) and 41) of the Act, the Commission has the authority to enforce these prohibitions. Section 38(a) provides that the Commission has the authority to adopt rules and regulations "as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this title." [83] The Commission believes that this is ample authority to adopt a rule interpreting the application of section 34(b) to specific circumstances.[84] In addition, to the extent that paragraph (b) affects the registration statements of money market funds, section 8(b) of the Act (15 U.S.C. 80a–8(b)) provides the Commission authority to prescribe the form of registration statements by adopting such rules as are necessary or appropriate in the public interest or for the protection of investors.[85]

As discussed in the Proposing Release, fund marketing and disclosure documents have encouraged investor expectations that money market funds are secure investments.[86] These expectations are reflected in the risk-limiting conditions of rule 2a–7 that are today being amended. The Commission believes that there is a significant danger of misleading investors if an investment company holds itself out as a money market fund when it engages in investment strategies not consistent with the risk-limiting conditions of rule 2a–7. It is therefore necessary and appropriate in the public interest and for the protection of investors for the Commission to adopt a new paragraph (b) of rule 2a–7 prohibiting an investment company from holding itself out as a "money market fund" unless it meets the risk-limiting conditions of rule 2a–7.

H. Money Market Fund Prospectus Disclosure

The proposed amendments to Forms N–1A and N–3 require that cover page of a money market fund prospectus to disclose prominently (i) that the shares of the money market fund are neither insured nor guaranteed by the U.S. Government and (ii) that there is no assurance that the fund will be able to maintain a stable net asset value of $1.00 per share. The proposal was widely supported by commenters and is being adopted substantially as proposed.[87]

Several commenters urged that the prescribed legend appear in money market fund sales literature and advertisements. In view of the important role that advertising and sales literature play in marketing money market funds, the Commission has adopted this suggestion.[88]

I. Funds Eligible to Quote Seven-Day Yields

The Commission is adopting the proposed amendment to rule 482 under the 1933 Act to prohibit funds that do not meet the risk-limiting conditions stated in rule 2a–7 from quoting a seven-day yield figure.[89] These funds, which under rule 2a–7, as amended, may not hold themselves out as money market funds, are treated as other types of mutual funds that quote thirty-day yield figures accompanied by total return figures. While money market funds that follow the risk-limiting provisions of rule 2a–7 are unlikely to incur capital losses or gains, the same may not hold true for funds not following the risk-limiting provisions. These funds, therefore, must also provide total return figures to investors which reflect the effect of capital losses or gains.[90]

III. Transition Period

The amendments to rules 2a–7, 2a41–1, 12d3–1 and 34b–1 and Form N–SAR under the 1940 Act [91] and rule 482 under the 1933 Act will become effective on June 1, 1991. If a money market fund has policies changeable only if authorized by a shareholder vote that are less restrictive than the rule as amended, but compliance with the amended rule will not violate these policies, the Commission believes that compliance with rule 2a–7, as amended, would not require a shareholder vote under sections 8(b) (1) and (2) of the Act. To avoid confusing shareholders, however, funds should consider submitting to shareholders at the next shareholder meeting proposals that will conform the fund's stated policies to the fund's actual policies in light of the revisions to rule 2a–7. The rule does not require funds to dispose of securities owned at the time of the adoption of the rule to comply with the quality and diversification requirements of the rule as amended. Moreover, the Commission will not object if a fund does not dispose of securities owned at the time of the adoption of the rule to comply with the amended rule's maximum maturity provisions.

The amendments to rules 482 under the 1933 Act and 34b–1 under the 1940 Act regarding advertisements and sales literature also become effective on June 1, 1991.[92] All advertisements and sales

[83] Section 38(a) of the Act provides that: The Commission shall have the authority from time to time to make, issue, amend and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this title, including rules and regulations defining accounting, technical, and trade terms used in this title, and prescribing the form or forms in which information required in registration statements, applications, and reports to the Commission shall be set forth. For the purposes of its rules or regulations the Commission may classify persons, securities, and other matters within its jurisdiction and prescribe different requirements for different classes of persons, securities, or matters.

[84] See, *e.g.*, rule 34b–1 under the Act. Contrary to the commenter's assertion, the plain language of section 38(a) does not differ in substance from provisions of the other securities acts that grant the Commission authority to adopt rules necessary and appropriate to implement provisions of those acts. See, *e.g.*, section 19(a) of the 1933 Act (15 U.S.C. 77s(a)); section 23(a)(1) of the 1934 Act (15 U.S.C. 78w(a)(1)).

[85] If, as the commenter argued, section 38(a) only "elaborates on" authority specifically granted by sections of the Act such as sections 6(c), 17(d) or 17(e) (5 U.S.C. 80a–6c, 17(d) and 17(e)), the portion of section 38(a) that grants the Commission authority to adopt "such rules and regulations and orders as are necessary or appropriate to the exercise of powers conveyed elsewhere in this title * * *" would be superfluous because the authority specifically granted by the cited sections requires no "elaboration." See Sutherland Stat. Const. § 46.06 (4th Ed.) ("A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant, and so that one section will not destroy another unless the provision is the result of obvious mistake or error." (citations omitted)).

[86] See, *e.g.*, Money Market Funds: A Part of Every Financial Plan (publication of the Investment Company Institute), a pamphlet prepared by the major investment company trade association for distribution to the general public.

[87] Several technical revisions have been made. As proposed, the statement must disclose that the "securities of the fund are neither insured nor guaranteed by the U.S. Government." This has been changed to "an investment in the fund is neither insured nor guaranteed * * *" to reduce the likelihood that a reader would be confused between the securities issued by the fund and its portfolio securities. Second, a parenthetical has been added to the second part of the legend to make into account funds that stabilize their net asset value at a price other than $1.00. Third, an instruction has been added to permit a money market fund not stabilizing its net asset value to omit the second part of the legend. Finally, as proposed, the amendments require that the legend be "prominent" but do not require certain type size.

[88] Paragraph (a)(7) of rule 482, and the first paragraph of rule 34b–1, as amended.

[89] Paragraph (d) of rule 482, as amended.

[90] The Commission is also adopting conforming amendments to Item 22(a) of Form N–1A, Item 25(a) of Form N–3, and Item 21(a) of Form N–4, which set forth the yield formulas used by money market funds and money market-funded separate accounts issuing variable annuity contracts. The Commission is also making conforming amendments to rule 34b–1 under the 1940 Act, the rule governing mutual fund sales literature.

[91] The amendments to rules 2a41–1 and 12d3–1 conform certain references to paragraphs of rule 2a–7 to the amended rule.

[92] The amendments to Item 22 of Form N–1A, Item 25 of Form N–3 and Item 21 of Form N–4 do not require a fund that continues to hold itself out as a money market fund to amend its registration statement. However, as noted below, a fund that

Continued

literature used after that date must include the new legend.

The Commission is staggering the effective dates of the amendments to Item 1 of Forms N-1A and N-3 so that a fund will not be required to revise its registration statement to add the new cover page legend until its next post-effective amendment.[93] The amendments to Item 1 of Form N-1A and Item 1 of Form N-3 will be effective: (1) For investment companies whose registration statements become effective on or after May 1, 1991, and investment companies with fiscal years ending on December 31, as to prospectuses used on or after May 1, 1991; and (2) for all other investment companies, upon use of any prospectus contained in any post-effective amendment filed on or after May 1, 1991. If the registration statement of a fund discloses investment policies that are less restrictive than those required by the rule amendments, the Commission will not object if the fund does not, upon the effective date of the amendments to rule 2a-7, revise its disclosure provided the current disclosure is not misleading. For example, if a fund's registration statement states that the fund may invest in an unlimited amount of Second Tier Securities, a revision would not be necessary. However, if the registration statement states that a fund will invest twenty percent of its assets in Second Tier Securities, revision would be necessary.

It is possible that, upon the adoption of the amendments to rule 2a-7, some funds may choose no longer to hold themselves out as money market funds rather than comply with the rule's limitations. These funds would no longer be eligible to quote a seven-day yield under rule 482(d) and would be required to revise their registration statements and sales material. These funds also may have to revise their fundamental organizational documents. If the extent of the changes that any such fund would be required to make, or other circumstances, made it impossible for the fund to comply with the amended rules by their effective date, the Commission staff would entertain requests for "no action" relief.

elects not to hold itself out as a money market fund will have to amend its response to the applicable item of its registration statement if it plans to continue to advertise its performance.

[93] The Commission would not object if the post-effective amendment filed to add the cover page legend is filed pursuant to rules 485(b) or 486(b) (17 CFR 230.485(b) and 230.486(b)) if any other conditions for filing under paragraph (b) are met.

IV. Regulatory Flexibility Analysis

A summary of the Initial Regulatory Flexibility Analysis regarding the proposed rule and form amendments was published in the proposing release. One comment was received. The Commission has prepared a Final Regulatory Flexibility Analysis in accordance with 5 U.S.C. 603, a copy of which may be obtained by contacting Eli A. Nathans, Mail Stop 10-6, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549.

V. Statutory Authority

The Commission is amending rule 2a-7 under the exemptive and rulemaking authority set forth in sections 6(c) (15 U.S.C. 80a-6(c)), 8(b) (15 U.S.C. 80a-8(b)), 22(c) (15 U.S.C. 80a-22(c)), 34(b) (15 U.S.C. 80a-33(b)), and 38(a) (15 U.S.C. 80a-37(a)) of the Investment Company Act of 1940. The authority citations for the amendments to the rules and forms precede the text of the amendments.

VI. Text of Rule and Form Amendments

List of Subjects in 17 CFR Parts 230, 239, 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Commission is amending chapter II, title 17 of the Code of Federal Regulations as follows:

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for part 230 continues to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77f, 77g, 77h, 77j, 77s, 77sss, 78c, 78l, 78m, 78n, 78o, 78w, 79t, and 80a-37, as amended, unless otherwise noted.

2. Section 230.482 is amended by removing the period at the end of the paragraph (a)(6) and by replacing it with a semicolon, by adding a new paragraph (a)(7) and revising paragraph (d) to read as follows:

§ 230.482 Advertising by an investment company as satisfying requirements of section 10.

(a) * * *

(7) In the case of an investment company that holds itself out to be a "money market" fund, it includes a prominent statement that (i) an investment in the fund is neither insured nor guaranteed by the U.S. Government and (ii) there can be no assurance that the fund will be able to maintain a stable net asset value of $1.00 per share (or, if other than $1.00, the applicable net asset value); *provided, however*, that a money market fund not holding itself out as maintaining a stable net asset value may omit the portion of the statement required by paragraph (a)(7)(ii) of this section.

* * * * *

(d) In the case of a "money market" fund, any quotation of the money market fund's yield contained in an advertisement shall be:

(1) A quotation of current yield based on the method of computation prescribed in Form N-1A (set forth in §§ 239.15A and 274.11A of this chapter), Form N-3 (set forth in §§ 239.17a and 274.11b of this chapter), or Form N-4 (set forth in §§ 239.17b and 274.11c of this chapter) and identifying the length of and the date of the last day in the base period used in computing that quotation; or

(2) A quotation of current yield described in paragraph (d)(1) of this section and a corresponding quotation of effective yield based on the method of computation prescribed in Forms N-1A, N-3, or N-4; *Provided*, That when both a quotation of current yield and effective yield are used in the same advertisement, each quotation shall relate to an identical base period and shall be given equal prominence.

* * * * *

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

3. In the authority citation to part 270, the general authority continues to read as set forth below, the specific authority for §§ 270.2a-7, 270.2a41-1 and 270.12d3-1 is revised as follows:

Sections 38, 40, 54 Stat. 841, 842; 15 U.S.C. 80a-37, 80c-89; The Investment Company Act of 1940, as amended, 15 U.S.C. 80a-1 *et seq.*; unless otherwise noted;

* * * * *

Sections 270.2a-7, 270.2a41-1 and 270.12d3-1 also issued under secs. 6(c) (15 U.S.C. 80a-6(c)), 22 (15 U.S.C. 80a-22), 34 (15 U.S.C. 80a-33), 38 (15 U.S.C. 80a-37), and 40 (15 U.S.C. 80a-39);

* * * * *

4. By revising section 270.2a-7 to read as follows:

§ 270.2a-7 Money market funds.

(a) *Definitions*—(1) *Amortized Cost Method* of valuation shall mean the method of calculating an investment company's net asset value whereby portfolio securities are valued at the fund's acquisition cost as adjusted for amortization of premium or accretion of discount rather than at their value based on current market factors.

(2) *Business day* means any day, other than Saturday, Sunday, or any customary business holiday.

(3) *Collateralized fully* in the case of a repurchase agreement shall mean that:

(i) The value of the securities collateralizing the repurchase agreement (reduced by the transaction costs (including loss of interest) that the money market fund reasonably could expect to incur if the seller defaults) is, and during the entire term of the repurchase agreement remains, at least equal to the resale price provided in the agreement; and

(ii) The money market fund or its custodian either has actual physical possession of the collateral or, in the case of a security registered on a book entry system, the book entry is maintained in the name of the money market fund or its custodian; and

(iii) The money market fund retains an unqualified right to possess and sell the collateral in the event of a default by the seller; and

(iv) The collateral consists entirely of Government securities or securities that, at the time the repurchase agreement is entered into, are rated in the highest rating category by the Requisite NRSROs.

(4) *Demand Feature* shall mean a Put that entitles the holder to receive the principal amount of the underlying security or securities and that may be exercised either:

(i) At any time on no more than 30 days' notice; or

(ii) At specified intervals not exceeding 397 calendar days and upon no more than 30 days' notice.

(5) *Eligible Security* shall mean:

(i) A security with a remaining maturity of 397 days or less that is rated (or that has been issued by an issuer that is rated with respect to a class of Short-term debt obligations, or any security within that class, that is comparable in priority and security with the security) by the Requisite NRSROs in one of the two highest rating categories for Short-term debt obligations (within which there may be sub-categories or gradations indicating relative standing); or

(ii) A security:

(A) That at the time of issuance was a Long-term security but that has a remaining maturity of 397 calendar days or less, and

(B) Whose issuer has received from the Requisite NRSROs a rating, with respect to a class of Short-term debt obligations (or any security within that class) that is now comparable in priority and security with the security, in one of the two highest rating categories for Short-term debt obligations (within which there may be sub-categories or gradations indicating relative standing); or

(iii) An Unrated Security that is of comparable quality to a security meeting the requirements of paragraph (a)(5) (i) or (ii) of this section, as determined by the money market fund's board of directors: *Provided, however,* That:

(A) The board of directors may base its determination that a Standby Commitment is an Eligible Security upon a finding that the issuer of the commitment presents a minimal risk of default; and

(B) A security that at the time of issuance was a Long-term security but that has a remaining maturity of 397 calendar days or less and that is an Unrated Security is not an Eligible Security if the security has a Long-term rating from any NRSRO that is not within the NRSRO's two highest categories (within which there may be sub-categories or gradations indicating relative standing).

(6) *First Tier Security* shall mean any Eligible Security that:

(i) Is rated (or that has been issued by an issuer that is rated with respect to a class of Short-term debt obligations, or any security within that class, that is comparable in priority and security with the security) by the Requisite NRSROs in the highest rating category for Short-term debt obligations (within which there may be sub-categories or gradations indicating relative standing); or

(ii) Is a security described in paragraph (a)(5)(ii) of this section whose issuer has received from the Requisite NRSROs a rating, with respect to a class of Short-term debt obligations (or any security within that class) that now is comparable in priority and security with the security, in the highest rating category for Short-term debt obligations (within which there may be sub-categories or gradations indicating relative standing); or

(iii) Is an Unrated Security that is of comparable quality to a security meeting the requirements of clauses (i) and (ii) of paragraph (a)(6) of this section, as determined by the fund's board of directors.

(7) *Floating Rate Instrument* shall mean a security the terms of which provide for the adjustment of its interest rate whenever a specified interest rate (such as a bank's designated prime lending rate) changes and which, at any time, can reasonably be expected to have a market value that approximates its par value.

(8) *Government security* shall mean any Government security as defined in section 2(a)(16) of the Act.

(9) *Long-term* shall mean having a remaining maturity greater than 366 days.

(10) *NRSRO* shall mean any nationally recognized statistical rating organization, as that term is used in paragraphs (c)(2)(vi) (E), (F) and (H) of rule 15c3-1 under the Securities Exchange Act of 1934 (17 CFR 240.15c3-1(c)(2)(vi) (E), (F) and (H)), that is not an affiliated person, as defined in section 2(a)(3)(c) of the Act (15 U.S.C. 80a-2(a)(3)(c)), of the issuer of, or any insurer, guarantor or provider of credit support for, the instrument.

(11) *Penny-Rounding Method* of pricing shall mean that 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.

(12) A *Put* shall mean a right to sell a specified underlying security or securities within a specified period of time and at a specified exercise price, that may be sold, transferred or assigned only with the underlying security or securities.

(13) *Requisite NRSROs* shall mean

(i) Any two NRSROs that have issued a rating with respect to a security or class of debt obligations of an issuer, or

(ii) If only one NRSRO has issued a rating with respect to such security or issuer at the time the fund purchases or rolls over the security, that NRSRO.

(14) *Second Tier Security* shall mean any Eligible Security that is not a First Tier Security.

(15) *Short-term* shall mean having a remaining maturity of 366 days or less.

(16) *Standby Commitment* shall mean a Put that entitles the holder to achieve same day settlement and to receive an exercise price equal to the amortized cost of the underlying security or securities plus accrued interest, if any, at the time of exercise.

(17) *Tax exempt fund* shall mean any money market fund that holds itself out as distributing income exempt from regular federal income tax.

(18) *Total Assets* shall mean, with respect to a money market fund using the Amortized Cost Method, the total amortized cost of its assets and, with respect to any other money market fund, the total market-based value of its assets.

(19) An *Unconditional Put* or an *Unconditional Demand Feature* shall mean a Put or a Demand Feature (including any guarantee, letter of credit or similar unconditional credit enhancement) that by its terms would be readily exercisable in the event of a

default in payment of principal or interest on the underlying security or securities.

(20) Any *Unrated Security* shall mean:

(i) A security with a remaining maturity of 397 days or less issued by an issuer that does not have a current Short-term rating assigned by any NRSRO:

(A) To the security, or

(B) To the issuer with respect to a class of Short-term debt obligations (or any security within that class) that is comparable in priority and security with the security; and

(ii) A security:

(A) That at the time of issuance with a Long-term security but that has a remaining maturity of 397 calendar days or less, and

(B) Whose issuer has not received from any NRSRO a rating with respect to a class of Short-term debt obligations (or any security within that class) that now is comparable in priority and security with the security; and

(iii) A security that is a rated security and is the subject of an external credit support agreement that was not in effect when the security (or the issuer) was assigned its rating.

A security is not an Unrated Security if any Short-term debt obligation ("reference security") that is issued by the same issuer and is comparable in priority and security with that security is rated by a NRSRO. The status of such security as an Eligible Security or First Tier Security shall be the same as that of the reference security.

(21)(a) A *Variable Rate Instrument* shall mean a security the terms of which provide for the adjustment of its interest rate on set dates (such as the last day of a month or calendar quarter) and which, upon such adjustment, can reasonably be expected to have a market value that approximates its par value.

(b) *Holding Out*. It shall be an untrue statement of material fact within the meaning of section 34(b) of the Act (15 U.S.C. 80a-33(b)) for a registered investment company, in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Act, including any advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors that is required to be filed with the Commission by section 24(b) of the Act (15 U.S.C. 80a-24(b)) to:

(1) Adopt the term "money market" as part of its name or title or the name or title of any redeemable security of which it is the issuer, or

(2) Hold itself out to investors as, or adopt a name which suggests that it is, a money market fund or the equivalent of a money market fund,

unless such registered investment company meets the conditions of paragraphs (c)(2), (c)(3), and (c)(4) of this section. For purposes of this paragraph, a name which suggests that a registered investment company is a money market fund or the equivalent thereof shall include one which uses such terms as "cash," "liquid," "money," "ready assets" or similar terms.

(c) *Share Price Calculations*. The current price per share, for purposes of distribution, redemption and repurchase, of any redeemable security issued by any registered investment company ("money market fund"), notwithstanding the requirements of section 2(a)(41) of the Act (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 by use of the Amortized Cost Method or the Penny-Rounding Method: *Provided, however*, That:

(1) *Board Findings*. The board of directors of the money market fund shall determine, in good faith, that it is in the best interests of the fund and its shareholders to maintain a stable net asset value per share or stable price per share, by virtue of either the Amortized Cost Method or the Penny-Rounding Method, 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.

(2) *Portfolio Maturity*. The money market fund shall maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value per share or price per share: *Provided, however*, That the money market fund will not:

(i) Except as provided in paragraph (c)(2)(ii) of this section, purchase any instrument with a remaining maturity of greater than 397 calendar days, or

(ii) In the case of a money market fund not using the Amortized Cost Method, purchase a Government security with a remaining maturity of greater than 762 calendar days; or

(iii) Maintain a dollar-weighted average portfolio maturity that exceeds ninety days.

(3) *Portfolio Quality*. The money market fund will limit its portfolio investments, including Puts and repurchase agreements, to those United States dollar-denominated instruments that its board of directors determines present minimal credit risks (which determination must be based on factors pertaining to credit quality in addition to the rating assigned to such instruments by a NRSRO and which are at the time of acquisition Eligible Securities. In the case of an Unrated Security (including a demand instrument) other than a Government Security, or a security that is an Eligible Security based on the rating of one NRSRO, the acquisition of each such security by the money market fund must be approved or ratified by the money market fund's board of directors. For purposes of this section:

(i) A demand instrument that has an Unconditional Demand Feature may be determined to be an Eligible Security or a First Tier Security based solely on whether the Unconditional Demand Feature is an Eligible Security or First Tier Security, as the case may be; and

(ii) A demand instrument that does not have an Unconditional Demand Feature is not an Eligible Security or a First Tier Security unless it meets the requirements for being an Eligible Security or First Tier Security, as the case may be, and, in addition, the demand instrument or the Long-term debt securities of the issuer of the demand instrument have been rated by the Requisite NRSROs in one of the two highest rating categories for Long-term debt obligations (within which there may be sub-categories or gradations indicating relative standing), or, if unrated, are determined to be of comparable quality by the money market fund's board of directors.

(4)(i) *Portfolio Diversification: General*. Except for a Tax exempt fund, immediately after the acquisition of any security (other than a Government security):

(A) The money market fund shall not have invested more than five percent of its Total Assets in securities issued by the issuer of the security: *Provided, however*, That a fund may invest more than five percent of its Total Assets in the First Tier Securities of a single issuer for a period of up to three Business days after the purchase thereof (subject to section 5(b)(1) of the Act (15 U.S.C. 80a-5(b)(1)) if the money market fund is a diversified investment company): *Provided, further*, That the fund may not make more than one investment in accordance with the foregoing proviso at any time; and

(B) In the event that such security is a Second Tier Security, the money market fund shall not have invested more than

(*1*) The greater of one percent of its Total Assets or one million dollars in securities issued by that issuer which, when acquired by the fund (either initially or upon any subsequent roll over) were Second Tier Securities, and

(2) Five percent of its Total Assets in securities which, when acquired by the fund (either initially or upon any subsequent roll over) were Second Tier Securities.

For purposes of making calculations under paragraph (c)(4)(i)(A) of this section, a repurchase agreement shall be deemed to be an acquisition of the underlying securities, provided that the obligation of the seller to repurchase the securities from the money market fund is Collateralized Fully.

(ii) *Portfolio Diversification: Puts.* Immediately after the acquisition of any Put, no more than five percent of the money market fund's Total Assets may be invested in securities issued by or subject to Puts from the same institution, *Provided, however,* That if the money market fund is a Tax exempt fund, the foregoing condition shall only be applicable with respect to 75 percent of its Total Assets.

(iii) *General.* For purposes of paragraph (c)(4) of this section:

(A) A Put will be considered to be from the party to whom the money market fund will look for payment of the exercise price;

(B) An Unconditional Put will be considered to be a guarantee of the underlying security or securities; and

(C) A guarantee of, or Unconditional Put with respect to, a security will not be deemed to be issued by the institution providing the guarantee or the Put, provided that the value of all securities held by the money market fund and issued or guaranteed by the issuer providing the guarantee or Put shall not exceed ten percent of the money market fund's Total Assets.

(5)(i) *Security Downgrades.* In the event that (A) a portfolio security of a money market fund ceases to be a First Tier Security (either because it no longer has the highest rating from the Requisite NRSROs or, in the case of an Unrated Security, the board of directors of the money market fund determines that it is no longer of comparable quality to a First Tier Security), or (B) the money market fund's investment adviser (or any person to whom the money market fund's board of directors has delegated portfolio management responsibilities) becomes aware that any Unrated Security or Second Tier Security held by the money market fund has, since the security was acquired by the fund, been given a rating by any NRSRO below the NRSRO's second highest rating category, the board of directors of the money market fund shall reassess promptly whether such security presents minimal credit risks and shall cause the money market fund to take such action as the board of directors determines is in the best interests of the money market fund and its shareholders: *Provided, however,* That the reassessment required by paragraph (c)(5)(i)(B) of this section is not required if, in accordance with the procedures adopted by the board of directors, the security is disposed of (or matures) within five Business days of the adviser becoming aware of the new rating and the board is subsequently notified of the adviser's actions.

(ii) *Defaults and Other Events.* In the event:

(A) Of a default with respect to a portfolio security (other than an immaterial default unrelated to the financial condition of the issuer); or

(B) A portfolio security of a money market fund ceases to be an Eligible Security; or

(C) It has been determined that a security no longer presents minimal credit risks;

absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money market fund (which determination may take into account, among other factors, market conditions that could affect the orderly disposition of the security), the money market fund shall dispose of such security as soon as practicable consistent with achieving an orderly disposition of the security, by sale, exercise of any Demand Feature or otherwise.

(iii) *Notice to the Commission.* In the event of a default with respect to one or more portfolio securities (other than an immaterial default unrelated to the financial condition of the issuer) which immediately before default accounted for ½ of 1 percent or more of a money market fund's Total Assets, the money market fund shall promptly notify the Commission of such fact and the actions the money market fund intends to take in response to such situation. Notification under this paragraph shall be made telephonically or by means of a facsimile transmission, followed by letter sent by first class mail, directed to the attention of the Director of the Division of Investment Management.

(6) *Required Procedures: Amortized Cost Method.* In the case of a money market fund using the Amortized Cost Method:

(i) In supervising the money 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, as a particular responsibility within the overall duty of care owed to its shareholders, shall establish written 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 adopted by the board of directors shall be the following:

(A) Written procedures providing that 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, shall be calculated at such intervals as the board of directors determines appropriate and reasonable in light of current market conditions; periodic review by the board of directors 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; and

(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 shall promptly consider what action, if any, should be initiated by the board of directors; and

(C) Where the board of directors believes 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 of existing shareholders, it shall cause the fund to take such action as it deems appropriate to eliminate or reduce to the extent reasonably practicable such dilution or unfair results.

(7) *Required Procedures: Penny-Rounding Method.* In the case of a money market fund using the Penny-Rounding Method, in supervising the money 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 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 percent, will

not deviate from the single price established by the board of directors.

(8) *Record Keeping and Reporting.* The money market fund will record, maintain, and preserve permanently in an easily accessible place a written copy of the procedures (and any modifications thereto) described in paragraphs (c)(5), (c)(6), (c)(7) and (e) 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' 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' 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(a)). If any action was taken pursuant to paragraphs (c)(5)(ii) (with respect to defaulted securities) or (c)(6)(ii)(B) of this section, the money market fund will attach an exhibit to the Form N-SAR (17 CFR 274.101) filed for the period in which the action was taken describing with specificity the nature and circumstances of such action. The money market fund will report in an exhibit to such Form any securities it holds on the final day of the reporting period that are not Eligible Securities.

(d) *Maturity of Portfolio Instruments.* For the purposes of this rule, the maturity of a portfolio instrument shall be deemed to be the period remaining (calculated from the trade date or such other date on which the fund's interest in the instrument is subject to market action) until the date noted on the face of the instrument as the date on which the principal amount 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:

(1) 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 every 762 days shall be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate.

(2) A Variable Rate Instrument, the principal amount of which is scheduled on the face of the instrument to be paid in 397 calendar days or less shall be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate.

(3) A Variable Rate Instrument that is subject to a Demand Feature shall be deemed to have a maturity equal to the longer of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand.

(4) A Floating Rate Instrument that is subject to a Demand Feature shall be deemed to have a maturity equal to the period remaining until the principal amount can be recovered through demand.

(5) A repurchase agreement shall be deemed to have 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 date is specified, but the agreement is subject to a demand, the notice period applicable to a demand for the repurchase of the securities.

(6) A portfolio lending agreement shall 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 date is specified, but the agreement is subject to demand, the notice period applicable to a demand for the return of the loaned securities.

(e) *Delegation.* The money market fund's board of directors may delegate to the fund's investment adviser or officers the responsibility to make any determination required to be made by the board of directors under this section (other than the determinations required by the second sentence of paragraph (c)(3) (which may be delegated subject to ratification by the money market fund's board of directors) and paragraphs (c)(1), (c)(5)(i)(B), (c)(5)(ii), (c)(6)(i), (c)(6)(ii), and (c)(7) of this section) provided that the board:

(1) Establishes and periodically reviews written guidelines (including guidelines for determining whether instruments present minimal credit risks as required in paragraph (c)(3) of this section) and procedures under which the delegate makes such determinations; and

(2) Exercises adequate oversight (through periodic reviews of fund investments and the delegate's procedures in connection with investment decisions and prompt review of the adviser's actions in the event of the default of a security that requires notification of the Commission under paragraph (c)(5)(iii) of this section) to assure that the guidelines and procedures are being followed.

5. By revising the introductory text of paragraph (a) of § 270.2a41-1 as follows:

§ 270.2a41-1 Valuation of standby commitments by registered investment companies.

(a) A standby commitment as defined in rule 2a-7(a)(16) under the Act (17 CFR 270.2a-7(a)(16)) may be assigned a fair value of zero, Provided, That:

* * * * *

6. By revising paragraph (d)(8)(v) of § 270.12d3-1 as follows:

§ 270.12d3-1 Exemption of acquisitions of securities issued by persons engaged in securities related businesses.

* * * * *

(d) * * *

(8) * * *

(v) Acquisition of puts, as defined in rule 2a-7(a)(12) under the Act (17 CFR 270.2a-7(a)(12)), provided that, immediately after the acquisition of any put, the company will not, with respect to 75 percent of the total value of its assets, have invested more than five percent of the total value of its assets in securities underlying puts from the same institution. An unconditional put shall not be considered a put from that institution, provided, that, the value of all securities issued or guaranteed by the same institution and held by the investment company does not exceed ten percent of the total value of the company's assets. For the purposes of this section, a put will be considered to be from the party to whom the company will look for payment of the exercise price and an unconditional put, as defined in rule 2a-7(a)(19) under the Act (17 CFR 270.2a-7(a)(19)), will be considered to be a guarantee of the underlying security or securities.

* * * * *

7. By revising the introductory text of § 270.34b-1 to read as follows:

§ 270.34b-1 Sales literature deemed to be misleading.

Any advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors that is required to be filed with the Commission by section 24(b) of the Act (15 U.S.C. 80a-24(b)) and that contains any investment company performance data (other than a report to shareholders under section 30(d) of the Act (15 U.S.C. 80a-29(d)) containing only performance data for the period of the report ("sales literature") shall have omitted to state a fact necessary in order to make the statements made therein not materially misleading unless the sales literature also contains performance data specified in paragraphs (a), (b), and (c) of this section, and the disclosure required by paragraph (a)(6) of this

section and, in the case of an investment company that holds itself out as a "money market fund," paragraph (a)(7) of rule 482 under the Securities Act of 1933 (17 CFR 230.482(a) (6) and (7)).

* * * * *

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

8. The authority citation for part 239 continues to read as follows:

Authority: The Securities Act of 1933, 15 U.S.C. 77a, *et seq.*, unless otherwise noted.

9. The authority citation for part 274 continues to read as follows:

Authority: The Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, unless otherwise noted.

10. Amending Form N-1A (17 CFR 239.15A and 274.11A), Part A, Item 1, paragraph (a), by deleting the word "and" at the end of paragraph (v), redesignating paragraph (vi) as paragraph (vii) and adding new paragraph (vi) and a new Instruction, to read as follows:

§ 239.15A Form N-1A, registration statement of open-end management investment companies.

§ 274.11A Form N-1A, registration statement of open-end management investment companies.

Note: Form N-1A is not codified in the Code of Federal Regulations.

* * * * *

Part A Information Required in a Prospectus

Item 1. Cover Page

(a) * * *

(vi) in the case of a Registrant holding itself out as a money market fund, a prominent statement that (A) an investment in the fund is neither insured nor guaranteed by the U.S. Government and (B) there can be no assurance that the fund will be able to maintain a stable net asset value of $1.00 share (or, if other than $1.00, the applicable net asset value); and

* * * * *

Instruction: Registrants not holding themselves out as maintaining a stable net asset value may omit the disclosure required by paragraph (B) of Item 1(a)(vi).

* * * * *

1. Revising Form N-1A (17 CFR 239.15A and 274.11A), part B, paragraph (a) of Item 22 to read as follows:

* * * * *

Part B Information Required in a Statement of Additional Information

* * * * *

Item 22. Calculation of Performance Data

(a) *Money Market Funds.* If the Registrant holds itself out as a "money market" fund and if it advertises a yield quotation or an effective yield quotation, furnish:

* * * * *

12. Amending Form N-3 (17 CFR 239.17a and 274.11b), part A, Item 1, paragraph (a), by deleting the word "and" at the end of paragraph (a)(viii), redesignating paragraph (a)(ix) as paragraph (a)(x) and adding new paragraph (a)(ix) to read as follows:

§ 239.17a Form N-3, registration statement for separate accounts organized as management investment companies.

§ 274.11b Form N-3, registration statement of separate accounts organized as management investment companies.

Note: Form N-3 is not codified in the Code of Federal Regulations.

* * * * *

Part A Information Required in a Prospectus

Item 1. Cover Page

(a) * * *

(ix) in the case of a Registrant holding itself out as a money market fund, a prominent statement that an investment in the fund is neither insured nor guaranteed by the U.S. Government; and

* * * * *

13. Amending Form N-3 (17 CFR 239.17a and 274.11b), part B, by revising paragraph (a) of Item 25 to read as follows:

* * * * *

Part B Information Required in a Statement of Additional Information

* * * * *

Item 25. Calculation of Performance Data

(a) *Money Market Accounts.* For each account or sub-account that holds itself out as a "money market" account or sub-account, and that advertises a yield quotation or an effective yield quotation, furnish:

* * * * *

14. Amending Form N-4 (17 CFR 239.17b and 274.11c), part B, by revising paragraph (a) of Item 21 to read as follows:

§ 239.17b Form N-4, registration statement for separate accounts organized as unit investment trusts.

§ 274.11c Form N-4, registration statement of separate accounts organized as unit investment trusts.

Note: Form N-4 is not codified in the Code of Federal Regulations.

* * * * *

Part B Information Required in a Statement of Additional Information

* * * * *

Item 21. Calculation of Performance Data

(a) *Money Market Funded Sub-Accounts.* For each sub-account that is funded by a "money market" fund, and for which the Registrant advertises a yield quotation or an effective yield quotation, furnish:

* * * * *

15. Amending Form N-SAR (17 CFR 274.101) by revising Instruction to Sub-item 77N, to read as follows:

§ 274.101 Form N-SAR, semi-annual report of registered investment companies.

Note: Form N-SAR is not codified in the Code of Federal Regulations.

* * * * *

General Instructions

* * * * *

Instructions to Specific Items

* * * * *

Item 77: Attachments

* * * * *

Sub-item 77N: Actions required to be reported pursuant to Rule 2a-7

A Registrant relying on rule 2a-7 (17 CFR 270.2a-7) to use the amortized cost method of valuation is required by paragraph (c)(8) of that rule: (1) To report actions that were taken with respect to defaulted securities held during the period covered by the report; (2) to report actions taken with respect to deviations from the money market fund's amortized cost price per share that may result in material dilution or other unfair results to investors or existing shareholders; and (3) to identify securities held on the final day of the reporting period that are no longer Eligible Securities, as defined by paragraph (a)(5) of that rule. If any such action was taken during the reporting period, or if such securities are held on the last day of the reporting period, this item should be checked and an exhibit attached, listing the securities and

specifically describing the nature and circumstances of the action.

* * * * *

16. Amending Guide 1 (Name of Registrant) to Form N-1A by deleting the second paragraph and Guide 1 (Name of Registrant) to Form N-3, by deleting the last sentence of the first paragraph.

Note: The Guides to Forms N-1A and N-3 are not codified in the Code of Federal Regulations.

By the Commission.

Dated: February 20, 1991.

Margaret H. McFarland,

Deputy Secretary.

Appendix: Conversion Table

Note: The conversion table is not codified in the Code of Federal Regulations.

	Prior Rule
Amended Rule Is Found in:	
(a)	(c)
(a)(1)	(c)(1)
(a)(2) new	* * *
(a)(3) new	* * *
(a)(4)	(c)(5)
(a)(5) new	* * *
(a)(6) new	* * *
(a)(7)	(c)(8)
(a)(8) new	* * *
(a)(9) new	* * *
(a)(10)	(c)(9)
(a)(11)	(c)(2)
(a)(12)	(c)(3)
(a)(13) new	* * *
(a)(14) new	* * *
(a)(15) new	* * *
(a)(16)	(c)(4)
(a)(17) new	* * *
(a)(18) new	* * *
(a)(19) new	* * *
(a)(20) new	* * *
(a)(21)	* * *
(b) new	* * *
(c)	(a)
(c)(1)	(a)(1)
(c)(2)	(a)(2)(iii), (a)(3)(ii)
(c)(2)(i)	(a)(2)(iii)(A), (a)(3)(ii)(A)
(c)(2)(ii) new	* * *
(c)(2)(iii)	(a)(2)(iii)(B), (a)(3)(ii)(B)
(c)(3)	(a)(2)(iv), (a)(3)(iii)
(c)(3)(i) new	* * *
(c)(3)(ii) new	* * *
(c)(3)(iii) new	* * *
(c)(4) new	* * *
(c)(5) new	* * *
(c)(6)	(a)(2)
(c)(6)(i)	(a)(2)(i)
(c)(6)(ii)	(a)(2)(ii)
(c)(6)(ii)(A)	(a)(2)(ii)(A)
(c)(6)(ii)(B)	(a)(2)(ii)(B)
(c)(6)(ii)(C)	(a)(2)(ii)(C)
(c)(7)	(a)(3)
(c)(8)	(a)(2)(vi), (a)(2)(vii)
(d)	(b)
(d)(1)	(b)(1)
(d)(2)	(b)(2)
(d)(3)	(b)(3)
(d)(4)	(b)(4)
(d)(5)	(b)(5)
(d)(6)	(b)(6)
(e) new	* * *

[FR Doc. 91-4438 Filed 2-26-91; 8:45 am]

BILLING CODE 8010-01-M

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[T.D. 8320]

RIN 1545-AM55

Treatment of Certain Losses Attributable to Periods After October 31 of a Taxable Year of a Regulated Investment Company; Correction

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains a correction to the final regulations (T.D. 8320), which were published Wednesday, December 5, 1990 (55 FR 50174). The regulations concern the treatment by a regulated investment company (RIC) of a net capital loss, a net long-term capital loss, or a net foreign currency loss attributable to periods after October 31 of its taxable year (a "post-October loss").

FOR FURTHER INFORMATION CONTACT: Lauren G. Shaw (202) 566-3828 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of this correction, provide guidance relating to the treatment of a post-October loss in determining a RIC's taxable income, the amount that a RIC may designate as capital gain dividends, and the RIC's earnings and profits. The applicable tax law was amended by the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988.

Need for Correction

As published, the final regulations contain errors which may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (T.D. 8320), which were the subject of FR Doc. 90-28432, is corrected as follows:

§ 1.852-11 [Corrected]

Par. 1. On page 50177, column three, in § 1.852-11, paragraph (c)(3)(i), line sixteen, the phrase "company must treat items must be" is corrected to read "company must treat items that must be".

§ 602.101 [Corrected]

Par. 2. On page 50179, column one, instructional Par. 5 is corrected to read as follows:

"Par. 5. The table of OMB control numbers in § 602.101(c) is amended by removing the entry for § 1.852-11T and adding an entry reading "1.852-11 . . . 1545-1094"."

Dale D. Goode,

Federal Register Liaison Officer, Assistant Chief Counsel (Corporate).

[FR Doc. 91-4514 Filed 2-26-91; 8:45 am]

BILLING CODE 4830-01-M

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[A-1-FRL-3863-6]

Approval and Promulgation of Air Quality Implementation Plans; Massachusetts; Non-CTG RACT Determination for Acushnet Company, Titleist Golf Division, Plant A, in New Bedford

AGENCY: Environmental Protection Agency (EPA).

ACTION: Final rule.

SUMMARY: EPA is approving a State Implementation Plan (SIP) revision submitted by the Commonwealth of Massachusetts. This revision establishes and requires the use of reasonably available control technology (RACT) to reduce volatile organic compound (VOC) emissions from certain processes at Acushnet Company, Titleist Golf Division, Plant A, in New Bedford, Massachusetts. The intended effect of this action is to approve a source-specific RACT determination. This action is being taken in accordance with section 110 of the Clean Air Act.

EFFECTIVE DATE: This rule will become effective on March 29, 1991.

ADDRESSES: Copies of the documents relevant to this action are available for public inspection during normal business hours at the Air, Pesticides and Toxics Management Division, U.S. Environmental Protection Agency, Region I, One Congress Street, Tenth Floor, Boston, MA; Public Information Reference Unit, U.S. Environmental Protection Agency, 401 M Street SW., Washington, DC 20460; and Division of Air Quality Control, Department of Environmental Protection, One Winter Street, 8th Floor, Boston, MA 02108.

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