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SEC ADOPTS CHANGES TO MONEY MARKET FUND REGULATION

- 1 - February 22, 1991 TO: BOARD OF GOVERNORS NO. 13-91 MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 5-91 SEC RULES MEMBERS NO. 11-91 MONEY MARKET FUNDS AD HOC COMMITTEE NO. 6-91 PUBLIC INFORMATION COMMITTEE NO. 5-91 RE: SEC ADOPTS CHANGES TO MONEY MARKET FUND REGULATION

_____ As we previously informed you, the SEC proposed amendments to Rule 2a-7 of the Investment Company Act, which currently governs most money market funds, and to other rules applying to money market funds (See Memorandum to Board of Governors No. 50- 90, Money Market Members - One Per Complex No. 9-90, SEC Rules Members No. 51-90 and Public Information Committee No. 22-90, dated July 20, 1990). On February 13th, the SEC adopted amendments to those rules. The SEC's release states that, "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." Set forth below is a summary of the newly adopted requirements in Rule 2a-7 and other rules applying to money market funds. A number of the Institute's comments on the SEC's proposal were adopted in the final amendments. A copy of the SEC release adopting these changes is attached. A. Amendments to Rule 2a-7 1. Quality a. Ratings - A money market fund may purchase a security that has received the highest rating by any two nationally recognized statistical rating agencies ("NRSROs"). If only one rating agency has rated the security, that rating is determinative. (However, the board must make certain findings in this instance, see paragraph 5 below). These securities are defined in the rule as "First Tier Securities". b. Second Tier Securities - A fund may invest only up - 2 - to 5% of its assets in Second Tier Securities (defined in the Rule as "Eligible Securities" that are not "First Tier Securities.") An Eligible Security is one that has received a rating in one of the two highest categories by any two NRSROs (or, if only one NRSRO has rated that security, by that NRSRO). In addition to the overall 5% limit on Second Tier Securities, a fund is limited as to the amount it may invest in Second Tier Securities of a single issuer to the greater of 1% of the fund's total net assets or $1 million. c. Unrated Securities - A fund may buy an unrated security that is determined by the fund to be of comparable quality to instruments that are Eligible Securities. The Rule clarifies that a security that has not been rated will not be considered an unrated security if its issuer has received ratings for outstanding securities that are comparable in priority and security with that security. With respect to long-term debt that has a remaining maturity of less than 13 months, the long-term debt is treated as unrated, provided the issuer does not have other comparable short-term debt outstanding that is rated. However, a fund may not purchase such a long-term security if it has a long-term rating from any NRSRO that is below the second highest category. The Rule has been amended to require that the fund's board of directors approve

or ratify the acquisition of each unrated security. (See paragraph 5 below regarding the board's duties). d. Split-Rated Securities - Split-rated securities that have received the highest rating by at least two NRSROs may be purchased by a fund. A split-rated security that has received the highest rating by only one agency may be purchased by a fund, but must be included in the 5% basket of Second Tier Securities. 2. Maturity a. Dollar-Weighted Average - The dollar-weighted average portfolio maturity requirement under Rule 2a-7 was reduced from 120 days to 90 days. b. Single Instruments - The maturity of a single portfolio instrument cannot exceed 13 months, except that a fund that does not use amortized cost valuation in reliance on Rule 2a-7 may purchase government securities with remaining maturities of up to 25 months. 3. Diversification A fund may not invest more than 5% of its assets in the - 3 - securities of any one issuer, except government securities (and repurchase agreements fully collateralized by government securities). However, the Rule contains a safe harbor from this requirement which allows funds to exceed the 5% limitation for up to three business days for assets invested in First Tier Securities. This allows funds to assure liquidity in the event of unexpected redemptions by shareholders or to invest unanticipated cash inflows. A fund may continue to invest up to 10% of its assets in securities subject to an unconditional put issued by any one institution. 4. Downgrades and Defaults a. Prompt Reassessment - Under the Rule, a fund must make a prompt reassessment as to whether a security presents minimal credit risks where (a) a security ceases to be a First Tier Security or, if unrated, ceases to be deemed to be of comparable quality and (b) where the fund's adviser becomes aware that any NRSRO has rated a Second Tier Security or an unrated security below its second highest rating. The release states that in connection with the requirement, the adviser is not expected to subscribe to every rating publication. Instead, it is expected that an adviser would become aware of a subsequent rating if it is recorded in the national financial press or in publications to which the adviser subscribes. The latter reassessment must be undertaken promptly by the board and not its delegate, unless the security is disposed of within five business days of the adviser becoming aware of the new rating and the board is subsequently notified of the adviser's actions. b. Disposition Absent Certain Circumstances - If a portfolio security is no longer an Eligible Security or is in default, the fund must dispose of the security as soon as practicable absent a specific finding by the board of directors that this would not be in the best interests of the fund. The Rule explicitly states that market conditions may be a factor that the board considers in making this determination. c. Notification - If a fund is holding a security that is in default that accounts for 1/2 of 1% or more of the fund's assets, the fund must notify the SEC. The notification is only required where the default relates to the financial condition of the issuer. In addition, funds will have to report on Form N-SAR actions taken with respect to defaulted securities held during the period covered by the report and identify securities held on the last day of the period covered by the report that are no longer Eligible Securities. 5. Board Responsibilities Under the Rule - 4 - A new paragraph has been added to Rule 2a-7 to clarify the - 5 - responsibilities of the fund's board of directors. The paragraph provides that the board may delegate all of its responsibilities to the adviser or an officer of the fund it has under the Rule other than the following: a. the determination that the fund should maintain a stable net asset value; b. the establishment of amortized cost method procedures to achieve a stable net asset value; c. the prompt reassessment of a Second Tier Security or unrated security if the adviser becomes aware that such has received a rating by any NRSRO below the NRSRO's second highest rating; d. the determination in the event of a default or a security ceasing to be an Eligible Security that disposal of the security would not be in the best interests of the fund; e. its obligation to approve or ratify the purchase of an unrated security (other than a government security) or a security that is an Eligible Security based on the rating of one NRSRO; and f. in connection with the penny-rounding pricing method, the duty to supervise the delegate.

With respect to the board's duties to approve or ratify the purchase of unrated securities or securities that have been rated by only one NRSRO, the Release states that it would not be necessary to convene the board for each purchase of such a security. Instead, the board 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 the guidelines established by the board, but the board would have to ratify the acquisition at the next meeting. (See f.n. 78 in the attached release). 6. Independent Credit Analysis The release reiterates the duty of the board of directors (or its delegate) to evaluate the creditworthiness of the issuer of any portfolio security and any entity providing a credit enhancement for a portfolio security. The release states that possession of a certain rating by a NRSRO is not a "safe harbor". The SEC clarifies in the release that the factors listed in the Division of Investment Management's May 8th letter concerning credit analysis are only examples of factors that should be considered in this analysis. - 6 - B. Disclosure in the Prospectus and in Advertisements and Sales Literature Money market funds are required to disclose prominently on the cover page of prospectuses (1) that investments in the money market fund are neither insured nor guaranteed by the U.S. Government and (2) that there is no assurance that the fund will be able to maintain a stable net asset value of $1.00 per share. Funds are also required to include this legend in advertisements and sales literature. C. Funds Eligible to Quote Seven Day Yields Rule 482 under the Securities Act has been amended to prohibit funds that do not meet the risk-limiting conditions stated in Rule 2a-7 (i.e., the limitations concerning maturity, diversification and quality) from quoting a seven-day yield figure. D. Holding Out Requirement A fund may not hold itself out as a money market fund or use a similar term in its name unless it complies with the maturity, diversification and quality requirements under Rule 2a-7. E. Transition Period Most of the amendments to the rules applying to money market funds will be effective June 1, 1991. However, investment companies whose registration statements become effective on or after May 1, 1991, and investment companies with fiscal years ending on December 31, must include the required disclosure on prospectuses used on or after May 1, 1991. For other investment companies, the disclosure must be included on prospectuses contained in any post-effective amendment filed on or after May 1, 1991. The release states that the SEC would not object if the post-effective amendment filed to add the cover page disclosure is filed pursuant to Rule 485(b), provided the conditions for filing thereunder are satisfied. The release also states that if the registration statement of a fund discloses investment policies that are less restrictive than those required by the new amendments, the SEC will not object if the fund does not revise its disclosure upon the effective date of the amendments, provided the current disclosure is not misleading. In addition, the release states that funds are not required to dispose of securities owned at the time of the adoption of the amendments to Rule 2a-7 to comply with the new diversification, maturity and quality requirements. - 7 - F. Tax-Exempt Funds The new diversification (5%) and quality requirements (5%/1% test for Second Tier Securities) do not apply to tax- exempt money market funds. However, it appears that the revised treatment of split-rated securities is applicable to tax-exempt funds. Thus, a security that has been rated in the second highest category by only one NRSRO and is also rated below the second highest category by another NRSRO is no longer eligible for purchase. Moreover, tax-exempt funds may only purchase unrated securities or securities rated by only one NRSRO that the board has approved or ratified, and the reassessment and disposition provisions of the rule are also applicable to tax- exempt funds. Amy B.R. Lancellotta Assistant General Counsel Attachment