§ 71.1 [Amended]

2. The incorporation by reference in 14 CFR 71.1 of the Federal Aviation Administration Order 7400.9D, Airspace Designations and Reporting Points, dated September 4, 1996, and effective September 16, 1996, is amended as follows:

Paragraph 6005 Class E airspace areas extending upward from 700 feet or more above the surface of the earth.

* * * * *

AWP NV E5 Battle Mountain, NV [Revised]

Battle Mountain Airport, NV
(lat. 40°35′54″N, long. 116°52′31″W)
Battle Mountain VORTAC
(lat. 40°34′09″N, long. 116°55′20″W)

That airspace extending upward from 700 feet above the surface within a 4.3-mile radius of the Battle Mountain Airport and 4.3 miles each side of the Battle Mountain VORTAC 218° radial, extending from the Battle Mountain VORTAC to 13.9 miles southwest of the Battle Mountain VORTAC and 4 miles each side of the Battle Mountain VORTAC 250° radial, extending from the Battle Mountain VORTAC to 14.2 miles west of the Battle Mountain VORTAC. That airspace extending upward from 1,200 feet above the surface within a 8.7 miles southeast and 13 miles northwest of the Battle Mountain VORTAC 218° and within 8.7 miles southeast and 11.7 miles northwest of the Battle Mountain VORTAC 038° radials extending from 25 miles southwest to 10.4 miles northeast of the Battle Mountain VORTAC and within 5.6 miles south and 7.8 miles north of the Battle Mountain VORTAC 077° and 257° radials, extending from 7 miles west to 16.1 miles east of the Battle Mountain VORTAC.

* * * * *

Issued in Los Angeles, California, on November 29, 1996.

Sabra W. Kaulia,

Assistant Manager, Air Traffic Division, Western-Pacific Region.

[FR Doc. 96–32018 Filed 12–17–96; 8:45 am]

BILLING CODE 4910–13–M

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230, 239, 270 and 274

[Release Nos. 33–7371, IC–22383, S7–29–96]

RIN 3235–AE17

Technical Revisions to the Rules and Forms Regulating Money Market Funds

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: The Commission is publishing for public comment proposed amendments to rules and forms under the Securities Act of 1933 and the Investment Company Act of 1940 that govern money market funds. Proposed technical amendments to rule 2a–7 under the Investment Company Act of 1940, the rule regulating money market funds, would, among other things, revise terminology used in the rule to reflect common market usage, and codify a number of interpretive positions taken by the staff of the Division of Investment Management. Proposed amendments to the advertising rules applicable to money market funds would clarify the formula used by money market funds to calculate yield and would prevent investors from being confused or misled by presentation of a money market fund's short-term total return in lieu of its yield.

DATES: Comments must be received on or before January 24, 1997.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Stop 6–9, Washington, DC 20549. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–29–96; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Electronically submitted comment letters will also be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT: Marjorie S. Riegel, Senior Counsel, Office of Chief Counsel, at (202) 942–0660, Division of Investment Management, Stop 10–6, 450 Fifth Street, NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (''Commission'') today is proposing for comment technical amendments to rule 2a–7 [17 CFR 2a–7] (''rule 2a–7'' or the ''rule'') under the Investment Company Act of 1940 [15 U.S.C. 80a–1, et seq.] (''1940 Act'') and conforming amendments to rules 2a41–1, 12d3–1 and 31a–1 under the 1940 Act [17 CFR 270.2a41–1, 270.12d3–1 and 270.31a–1]. The Commission also is proposing amendments to rule 482 [17 CFR 230.482] under the Securities Act of 1933 [15 U.S.C. 77a, et seq.] (''1933 Act''); and Forms N–1A [17 CFR 239.15A and 274.11A], N–3 [17 CFR 239.17a and 274.11b] and N–4 [17 CFR 239.17b and 274.11c].

I. Proposed Technical Amendments to Rule 2a–7

A. Background

On March 21, 1996, the Commission adopted amendments to rule 2a–7 that revised the rule to tighten the risk-limiting conditions imposed on tax exempt money funds and to address the treatment under the rule of certain instruments, such as asset backed securities (''March Amendments'').[1] Industry participants[2] have raised a number of questions concerning the application of the March Amendments in different contexts subsequent to their adoption. To respond to many of these questions, the Division of Investment Management published an interpretive letter (''Q&A Letter'').[3] The technical amendments proposed for public comment today would: (1) codify a number of interpretive positions taken by the staff in the Q&A Letter; (2) revise terminology used in the rule to reflect common market usage; (3) modify certain of the March Amendments so that the treatment accorded certain instruments (e.g., guarantees) by the rule more closely reflects the treatment accorded to those instruments by the financial markets; and (4) make certain other technical corrections.[4]

B. Discussion

1. Guarantees

a. Definition of ''Guarantee''

Many money market instruments are subject to guarantees and other forms of unconditional credit support that, among other things, provide the requisite credit quality to make an instrument eligible for investment under

[1] Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 21837 (March 21, 1996) [61 FR 13956 (March 28, 1996)] (''Release 21837''). Unless otherwise noted, all references to rule 2a–7, or to any paragraph of the rule, will be to the applicable paragraph of 17 CFR 270.2a–7, as amended by Release 21837. When a paragraph is renumbered in the rule as it is proposed to be amended, citations will be given both to rule 2a–7, ''as proposed to be amended,'' and to the rule as amended by Release 21837.

[2] In this Release, the term ''industry participants'' refers to those representatives of money market funds, investment advisers, law firms, issuers and underwriters of securities, and professional and trade associations that informally have sought advice from the staff concerning the application of the March Amendments, raised interpretive questions, or suggested changes to the rule.

[3] Investment Company Institute (pub. avail. May 9, 1996).

[4] The Commission has suspended the compliance date for certain of the March Amendments. See Revisions to the Rules Regulating Money Market Funds, Investment Company Act Release No. 22135 (Aug. 13, 1996) [61 FR 42786 (Aug. 19, 1996)] (''Compliance Date Release''), and Section III of this Release, which requests comment on a new compliance date.

rule 2a–7. Rule 2a–7 characterizes certain of these arrangements as ''puts'' [5] and ''unconditional puts.'' [6] This aspect of the definition has caused some confusion among industry participants. The Commission is, therefore, proposing to revise the rule's terminology by replacing references to ''put'' and ''unconditional put'' with a new term ''guarantee'' that would include a wide-range of arrangements designed to unconditionally support the credit of the issuer of a security.[7] In addition, the Commission would amend the credit quality and diversification provisions of the rule to incorporate the proposed term, as discussed below. Comment is requested on the proposed definition of the term ''guarantee.''

b. Credit Substitution

One type of guarantee to which rule 2a–7 specifically refers is an ''unconditional demand feature.'' [8] Rule 2a–7 permits a fund to rely on the credit quality of the issuer of an unconditional demand feature in determining the credit quality of the security.[9] Recognizing that a money market fund relies on the credit quality of the issuer of the unconditional demand feature rather than the issuer of the security subject to the demand feature in determining whether to invest in the security, the March Amendments permit a fund to exclude securities subject to an unconditional demand feature from the rule's issuer diversification standards if the demand feature is issued by a ''non-controlled person.'' [10] Because of the significance of demand features to a fund, the March Amendments provide that a demand feature is not eligible for fund investment unless (i) the demand feature (or provider of the demand feature) is rated by an NRSRO (''Rating Requirement''); [11] and (ii) arrangements are in place for a fund holding a security subject to a demand feature to be given notice in the event of a change in the identity of the issuer of the demand feature (''Notification Requirement''). [12]

Money market funds frequently invest in securities subject to financial guarantee (bond) insurance, letters of credit (''LOCs'') and other types of unconditional credit enhancements that may not fall within the definition of ''unconditional demand feature'' under the rule. As a result, for purposes of the rule, a fund holding securities subject to these types of unconditional credit enhancements may not be able to rely exclusively on the credit quality of the credit enhancement provider in determining the credit quality of the security, and may not exclude such securities from rule 2a–7's issuer diversification requirements. Industry participants have noted that the rule's treatment of securities subject to unconditional credit enhancements that do not fall within the definition of ''demand feature'' does not reflect the manner in which the financial markets treat these securities. Securities of this type typically trade on the basis of the credit quality of the provider of the credit enhancement.

The Commission is proposing amendments to rule 2a–7 that would modify the rule's credit quality standards to permit a fund to rely solely on the credit quality of the issuer of a guarantee in determining the credit quality of the security.[13] Accordingly, (i) the exclusion from the issuer diversification standards for securities subject to unconditional demand features from a non-controlled person would be expanded to include all securities subject to guarantees from a non-controlled person,[14] (ii) the Rating Requirement would be extended to all guarantees (with certain exceptions),[15] and (iii) the Notification Requirement would be extended to all guarantees for which substitution is permissible.[16]

c. Rating Requirement for Guarantees

The March Amendments to rule 2a–7 limit a money market fund to investing in securities subject to demand features (whether conditional or unconditional) that have received a short-term rating from an NRSRO.[17] The Commission explained that it believed that such a requirement would provide a degree of additional protection by ensuring input into the minimal credit risk determination from an outside source.[18] Because most banks and other institutions issuing demand features are rated, the Commission concluded that obtaining a rating was not an unreasonable or a burdensome requirement for an institution that is in the business of lending its credit and would not significantly diminish the supply of available, high quality, eligible securities.

As noted above, the Commission is proposing to extend the Rating Requirement to guarantees,[19] and to modify this requirement in three other respects: [20]

- Conditional demand features would be exempted from the Rating

[5] Paragraph (a)(16) of rule 2a–7 defines the term ''put'' to mean the right to sell a specified underlying security within a specified period of time and at a specified exercise price that may be sold, transferred, or assigned only with the underlying security.

[6] Paragraph (a)(27) of rule 2a–7 defines the term ''unconditional put'' to mean a put (including any guarantee, financial guarantee (bond) insurance, letter of credit or similar unconditional credit enhancement) that by its terms would be readily exercisable in the event of default in payment of principal or interest on the underlying security or securities.

[7] Paragraph (a)(14) of rule 2a–7, as proposed to be amended. The term ''guarantee'' would be defined to include an unconditional obligation of a person other than the issuer of the security to undertake to pay, upon presentment by the holder of the guarantee (if required), principal plus accrued interest when due upon default. This definition is for purposes of rule 2a–7 only, and is not intended to have any effect on the status of these investments under other provisions of the 1940 Act or under the other federal securities laws.

[8] Paragraph (a)(7) of rule 2a–7 defines the term ''demand feature'' to mean (i) a put that may be exercisable either: (A) at any time on no more than 30 calendar days' notice; or (B) at specified intervals not exceeding 397 calendar days and upon no more than 30 calendar days' notice; or (ii) a feature permitting the holder of an asset backed security unconditionally to receive principal and interest within thirteen months of making demand. An unconditional demand feature is a demand feature 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. See paragraphs (a)(25) and (a)(27) of rule 2a–7 (definitions of ''unconditional demand feature'' and ''unconditional put'').

[9] Paragraph (c)(3)(ii) of rule 2a–7. This provision was added to the rule in 1986. See Acquisition and Valuation of Certain Portfolio Instruments by Registered Investment Companies, Investment Company Act Release No. 14983 (March 12, 1986) [51 FR 9773 (March 21, 1986)].

[10] Paragraphs (c)(4)(i), (c)(4)(ii) and (c)(4)(iv) of rule 2a–7. The term ''unconditional demand feature issued by a non-controlled person'' is defined in paragraph (a)(26) of rule 2a–7.

[11] Paragraph (a)(9)(iii)(D)(1) of rule 2a–7.

[12] Paragraph (a)(9)(iii)(D)(2) of rule 2a–7.

[13] Paragraph (c)(3)(iii) of rule 2a–7, as proposed to be amended. Proposed amendments to the rule's credit quality provisions would reflect proposed amendments to other provisions of the rule by permitting a fund that holds a security that is subject to a guarantee and a conditional demand feature to substitute the rating of the guarantee for the rating of the underlying security. Paragraph (c)(3)(iv)(C) of rule 2a–7, as proposed to be amended. Consistent with the current rule, the fund would continue to be required to consider the rating of the conditional demand feature in evaluating the credit quality of the entire instrument. Paragraph (c)(3)(iv)(A) of rule 2a–7, as proposed to be amended.

[14] Paragraph (c)(4)(i) of rule 2a–7, as proposed to be amended. The term ''guarantee issued by a non-controlled person'' is defined in paragraph (a)(15) of rule 2a–7, as proposed to be amended.

[15] Paragraph (a)(10)(iii)(A) of rule 2a–7, as proposed to be amended. *See, infra* Section I.B.1.c. of this Release for a description of other proposed amendments to the Rating Requirement.

[16] Paragraph (a)(10)(iii)(B) of rule 2a–7, as proposed to be amended.

[17] See paragraph (a)(9)(iii)(D)(1) of rule 2a–7 (definition of ''eligible security''). Securities subject to demand features issued on or before June 3, 1996 were ''grandfathered,'' and are not required to be rated. Release 21837, supra note 1 at Section V.B. The June 3 ''grandfathering date'' was suspended until the Commission adopts the technical amendments proposed for comment in this release. See Compliance Date Release, supra note 4.

[18] Release 21837, supra note 1, at Section II.C.2.a.

[19] See, supra Section I.B.1.b. of this Release.

[20] See paragraph (a)(10)(iii)(A) of rule 2a–7, as proposed to be amended.

Requirement.[21] Conditional demand features do not act as a complete credit substitute for the credit quality of the underlying security, and a fund should be able, with relative ease, to substitute a new provider of a conditional guarantee for an existing provider that is experiencing credit problems.

- Any rating from an NRSRO (rather than only a short-term rating) would satisfy the Rating Requirement. A long-term rating would satisfy the primary objective of the Rating Requirement, which is to ensure input into the minimal credit risk determination by an outside source.[22] In addition, the long-term rating assigned to a guarantee may be relevant to a fund in evaluating the ability of the guarantor to perform under the terms of the guarantee.[23]
- A guarantee issued by a person that is controlled by, controls, or is under common control with the issuer of the security would be excepted from the Rating Requirement. An entity that guarantees a security issued by a controlled person may not be in the business of lending its credit, and such a requirement may by burdensome and result in a diminished supply of high quality, eligible securities.[24]

d. Demand Features and Guarantees Not Relied Upon

The March Amendments permit a fund that is not relying on a particular put for satisfaction of the rule's credit quality or maturity standards, or for liquidity, to exclude that put in determining its compliance with the rule's put diversification standards.[25] The Commission is proposing amendments to the rule that would provide that a demand feature or guarantee that is not relied upon to satisfy the rule's credit quality or diversification standards, or for liquidity, is not subject to any of the rule's requirements.[26]

2. Diversification and Quality Standards Applicable to Issuers

a. Second Tier Securities

The proposed amendments would clarify the scope of the issuer diversification standards applicable to taxable fund investment in second tier securities, and tax exempt fund investment in second tier conduit securities. Under rule 2a–7, a taxable fund may not invest more than one percent of its total assets in second tier securities issued by a single issuer, and a tax exempt fund may not invest more than one percent of its total assets in second tier conduit securities issued by a single issuer.[27] Proposed amendments to the rule's issuer diversification provisions would clarify that these limits are not applicable to securities subject to a guarantee issued by a non-controlled person.[28] Accordingly, such securities would only be subject to the rule's guarantee diversification requirements.[29]

b. Repurchase Agreements

Rule 2a–7 allows a fund to ''look through'' a repurchase agreement (''repo'') to the underlying collateral and thereby ignore the counterparty in determining compliance with the rule's diversification limitations when the obligation of the counterparty is ''collateralized fully.'' [30] A repo is collateralized fully if, among other things, it is collateralized by Government securities or other securities listed in the rule that permit the repo to receive favorable treatment under applicable bankruptcy law. This provision of the rule is intended to ensure that the securities collateralizing the repo can be liquidated promptly in the event of the bankruptcy of the counterparty. Since the publication of the March Amendments, numerous questions have been raised concerning the eligibility of cash and certain types of securities that, although not listed in the rule, may (or may not) constitute appropriate collateral to avoid a stay in the event of a bankruptcy.[31]

Although the determination of how a bankruptcy court might treat a repo is highly relevant for ''look through'' treatment under rule 2a–7, the Commission believes that specifying the types of collateral that meet the criteria of relevant provisions of bankruptcy law in rule 2a–7 is unnecessary to fulfill the underlying purposes of the rule. Therefore, the Commission is proposing to revise the rule to omit references to specific types of acceptable collateral. Under the proposed provision, a repo would be ''collateralized fully'' if (i) the collateral consists entirely of cash, Government securities, or other securities that are rated in the highest rating category by the requisite NRSROs, *and* (ii) upon an event of insolvency with respect to the seller, the repo would qualify under a provision of applicable insolvency law providing an exclusion from any general stay of creditors' rights against the seller.[32]

[21] The proposed definition of the term ''guarantee'' does not include conditional demand features. See paragraph (a)(14) of rule 2a–7, as proposed to be amended.

[22] Release 21837, supra note 1, at Section II.C.2.a.

[23] For example, a rating representing the long-term creditworthiness of a guarantor may be significant to a fund holding a long-term security subject both to a conditional demand feature that is relied upon to shorten the maturity of the underlying security and a guarantee. See paragraphs (c)(3)(iv)(A) and (c)(3)(iv)(C) of rule 2a–7, as proposed to be amended (a long-term security subject to a conditional demand feature is an eligible security only if the conditional demand feature is an eligible security, and the underlying security (or any guarantee of the underlying security) has received a short-term or long-term rating from the requisite NRSROs within the two highest short-term or long-term rating categories).

[24] The proposed amendments also would have the effect of exempting issuer-provided demand features from the Rating Requirement. This proposed provision is consistent with those provisions of the March Amendments that permit a fund to disregard issuer-provided demand features in determining its compliance with the rule's put diversification requirements. Paragraph (c)(4)(vi)(B)(*1*) of rule 2a–7; See Release 21837, supra note 1, at Section II.C.1.c (securities subject to ''issuer-provided demand features can be viewed as the functional equivalent of short-term securities that are 'rolled over' periodically.'').

[25] Paragraph (c)(4)(vi)(B)(*4*) of rule 2a–7.

[26] Paragraph (c)(5) of rule 2a–7, as proposed to be amended. This proposed amendment would codify a staff interpretive position. Q&A Letter, *supra* note 3, at Q&A 2 (a put that is not relied upon may be disregarded for all purposes under the rule, including the Rating Requirement, and provisions of the rule that require the fund's board of directors to reduce investment in securities subject to downgraded demand features absent a finding). A fund holding securities subject to demand features or guarantees that the fund's board of directors has determined are not being relied upon would be required to establish written procedures requiring periodic re-evaluations of this determination. Paragraph (c)(8)(ii) of rule 2a–7 (paragraph (c)(9)(ii) of rule 2a–7 as proposed to be amended).

[27] Paragraphs (c)(4)(iv)(A)(*1*) and (c)(4)(iv)(B)(*1*) of rule 2a–7.

[28] Paragraphs (c)(4)(i)(C)(*1*) and (c)(4)(i)(C)(*2*) of rule 2a–7, as proposed to be amended. Rule 2a–7 also limits a taxable fund and a tax exempt fund to investing no more than five percent of total assets in second tier securities and second tier conduit securities respectively. See paragraphs (c)(4)(iv)(A)(*2*) and (c)(4)(iv)(B)(*2*) of rule 2a–7 (''five percent quality test''). The proposed amendments would not make any substantive changes to the five percent quality test, and thus a taxable fund, for example, could not invest more than five percent of its total assets in second tier securities subject to a second tier demand feature. The proposed amendments would reorganize the rule text by including the five percent quality test in the paragraph of the rule that addresses portfolio quality, rather than portfolio diversification. See paragraph (c)(3)(ii) of rule 2a–7, as proposed to be amended (portfolio quality—second tier securities).

[29] Paragraphs (c)(4)(i) and (c)(4)(iii) of rule 2a–7, as proposed to be amended.

[30] Paragraphs (a)(4) and (c)(4)(vi)(A)(*1*) of rule 2a–7.

[31] See, e.g., Q&A Letter, supra note 3, at Q&A 12.

[32] Paragraphs (a)(5)(iv) and (a)(5)(v) of rule 2a–7, as proposed to be amended. In addition, a money market fund must evaluate the repo counterparty's creditworthiness in order to minimize the risk that money market funds do not enter into repos with parties that present a serious risk of becoming involved in bankruptcy proceedings. The Commission previously published a release setting forth the conditions under which the Division of Investment Management would not recommend enforcement action under Section 12(d)(3) of the 1940 Act if an investment company entered into a repo with persons engaged in securities-related businesses. Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 13005 (Feb. 2, 1983) [48

Continued

Under the proposed amendments, a fund entering into a repo collateralized by traditional types of Government securities (as most do) could conclude easily that the repo qualifies for ''look through'' treatment (assuming other requirements of the rule are met), while funds wishing to enter into repos using less traditional forms of collateral may rely on opinions of bankruptcy counsel.

c. Refunded Securities

The March Amendments permit a fund to ''look through'' refunded securities [33] to the escrowed securities in determining its compliance with the rule's issuer diversification standards under certain conditions, one of which is that an independent public accountant has certified that the escrowed Government securities, or any subsequent substitution of the escrowed securities, will satisfy all payments of principal, interest and applicable premiums on the refunded securities (collectively, the ''accountant's certifications'').[34] NRSROs in rating refunded securities typically require an independent third party to make the same determination.[35] Therefore, the Commission is proposing to provide that the accountant's certifications need not be obtained if, in connection with the placement of Government securities into the escrow account, the refunded securities have received a rating from an NRSRO in the highest category for debt obligations.[36]

d. Three-Day Safe Harbor

Rule 2a–7 permits a taxable or national fund to invest up to twenty-five percent of its total assets in the first tier securities of a single issuer for up to three business days (''three-day safe harbor'').[37] The proposed amendments restore unintentionally omitted language stating that a fund may not make more than one investment at any time during the three day period.[38]

3. *Asset Backed Securities and Synthetic Securities*

a. Rating Requirement

The March Amendments provide separate credit quality, diversification and maturity standards for asset backed securities and synthetic securities (collectively, ''ABSs''). The amendments provide that an ABS is not an eligible security unless it has received a rating from an NRSRO. The ABS covered by the rule include interests in pools of receivables, such as credit card debt, as well as short-term synthetic tax exempt securities.[39] The Commission adopted the rating requirement because an NRSRO rating would ensure that an independent legal, structural and credit analysis of the ABS had taken place. In addition, the Commission stated that, in light of the role that the NRSROs have played in the development of structured finance, a rating requirement should not be burdensome.[40]

The Commission is proposing to modify the rating requirement for ABS to exempt from the rating requirement any ABS substantially all the qualifying assets of which consist of the obligations of one or more municipal issuers.[41] In proposing the rating requirement for ABSs, the Commission noted that when an ABS consists of a large pool of financial assets, such as credit card receivables or mortgages, the ABS may not be susceptible to conventional means of credit risk analysis because credit quality is based not on a single issuer but an actuarial analysis of a pool of financial assets.[42] Industry participants have suggested that this is usually not the case with respect to synthetic structures and municipal pools, whose qualifying assets generally consist of no more than a few municipal issuers (or, in the case of some pools, several municipalities located in a particular state). Thus, the credit analysis for these structures is typically no different than that required for a security directly issued by the municipality.[43]

The Commission is also proposing to revise the rule to clarify that, consistent with other proposed provisions of the rule, an ABS subject to a guarantee (which generally would be required to rated [44]), would itself not be required to be rated by an NRSRO.[45] Under the proposed amendments, a fund holding an ABS fully supported by a guarantee would be permitted to substitute the credit quality of the guarantee in determining the credit quality of the ABS,[46] and to exclude the ABS in determining its compliance with the rule's issuer diversification standards.[47]

b. Diversification Standards

The March Amendments treat the special purpose entity as the issuer of the ABS and therefore require that rule 2a–7's diversification standards be met with respect to the special purpose entity. The amendments create an exception to this treatment, however, requiring a fund to ''look through'' the special purpose entity to any issuer of qualifying assets whose obligations constitute ten percent or more of the principal amount of the qualifying assets of the special purpose entity (''ten percent obligor'').[48] For diversification purposes, a fund is required to treat these ten percent obligors as if they issued a proportionate amount of the special purpose entity.[49]

Some or all of the qualifying assets of certain ABSs (''primary ABSs'') also consist of other ABSs (''secondary ABSs''). The proposed amendments would clarify that a ten percent obligor that is also the issuer of secondary ABSs would be deemed to have issued a portion of the assets of the primary ABS that such secondary ABSs represent. For purposes of identifying ten percent obligors, the proposed amendments would provide that a fund should

FR 5824 (Feb. 9, 1983)] (''Repo Release''). One of the conditions stated in the Repo Release was that the repo be ''fully collateralized,'' although a description of ''fully collateralized'' did not include all of the conditions in rule 2a–7, as amended by the March Amendments. A money market fund entering into a repo that is ''collateralized fully'' within the meaning of paragraph (a)(4) of rule 2a–7 (paragraph (a)(5) of rule 2a–7, as proposed to be amended) would meet the ''fully collateralized'' requirement of the Repo Release. Investment companies other than money market funds are not required to comply with this provision of rule 2a–7 to avoid violating Section 12(d)(3).

[33] Paragraph (a)(18) of rule 2a–7 generally defines ''refunded securities'' as securities whose payment is funded and secured by Government securities placed in an escrow account.

[34] Paragraphs (a)(18)(ii), (a)(18)(iii) and (c)(4)(vi)(A)(*2*) of rule 2a–7.

[35] *See, e.g.*, Standard & Poor's Municipal Finance Criteria, 176–177 (1996).

[36] Paragraph (a)(19)(iii) of rule 2a–7, as proposed to be amended.

[37] Paragraph (c)(4)(iii) of rule 2a–7 (paragraph (c)(4)(i)(A) of rule 2a–7, as proposed to be amended). Because single state funds are required to be diversified only as to seventy-five percent of their assets, they have available a twenty-five percent basket to accommodate purchases in excess of five percent. Paragraph (c)(4)(ii) of rule 2a–7 (paragraph (c)(4)(i)(B) of rule 2a–7, as proposed to be amended). As a result, the three-day safe harbor of rule 2a–7 is not available for single state funds.

[38] Paragraph (c)(4)(i)(A) of rule 2a–7, as proposed to be amended.

[39] Synthetic securities are described in Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 19959 (Dec. 17, 1993) [58 FR 68585 (Dec. 28, 1993)] (''Release 19959'') at Section II.C.4.

[40] Release 21837, *supra* note 1 at Section II.E.4.

[41] Paragraph (a)(10)(ii)(B) of rule 2a–7, as proposed to be amended.

[42] Release 19959, *supra* note 39, at text accompanying n.111.

[43] Industry representatives have also suggested that because many synthetics are not rated, the rating requirement may restrict available supply. ABSs that involve the securitization of financial assets, on the other hand, are typically rated, and the rating requirement does not impose any unnecessary burden.

[44] Paragraph (a)(10)(iii)(A) of rule 2a–7, as proposed to be amended.

[45] Paragraph (a)(10)(ii)(B) of rule 2a–7, as proposed to be amended.

[46] Paragraph (c)(3)(iii) of rule 2a–7, as proposed to be amended.

[47] Paragraph (c)(4)(i) of rule 2a–7, as proposed to be amended.

[48] Paragraph (c)(4)(vi)(A)(*4*) of rule 2a–7.

[49] *Id.*; Paragraph (c)(4)(ii)(D)(*1*) of rule 2a–7, as proposed to be amended.

continue down the chain of ten percent obligors until a special purpose entity with no ten percent obligors is reached.[50] Finally, the Commission is proposing to clarify that in the case of the obligations of a ten percent obligor that are treated as being held directly by the fund, any demand features and guarantees supporting the obligations are treated as being held by the fund and should be subject to the rule's demand feature and guarantee diversification tests.[51] Comment is requested on the proposed amendments.

Some industry participants have raised concern about the ABS diversification test because a fund could invest more than ten percent of its total assets in ABSs issued by a special purpose entity with one or more ten percent obligors.[52] A fund's investment of a significant portion of its total assets in a single ABS might expose the fund and investors to an undue amount of structural risk (*e.g.*, the risk that the special purpose entity might be affected by the bankruptcy of the sponsor). Comment is requested whether the rule should restrict direct and indirect fund investment in the obligations of a single special purpose entity to a specified percentage of fund assets (*e.g.*, ten percent of fund assets).

c. Demand Features and Guarantees

Under rule 2a–7, a fund holding an ABS subject to a demand feature from a controlled person is subject to the rule's ten percent diversification limitation applicable to demand features and puts, and thus may not be able to include this investment in its ''twenty-five percent basket.'' [53] The sponsor of an ABS may own residual interests in the special purpose entity, in which case the sponsor may ''control'' the special purpose entity within the meaning of section 2(a)(9) of the 1940 Act.[54]

The Commission restricted fund use of the twenty-five percent basket to non-controlled persons to minimize a fund's concentration of assets in a single economic enterprise.[55] This provision of the rule, then, was designed to limit a fund's aggregate exposure to the risks of related, active businesses. Permitting a fund to invest more than five percent of its total assets in an ABS subject to a demand feature provided by a sponsor, however, would not have this effect, because the special purpose entity, unlike an active enterprise, is a limited purpose vehicle created solely for the purpose of issuing fixed income securities based on the cash flow of the qualifying assets. The Commission is therefore proposing amendments to the definitions of ''demand feature issued by a non-controlled person'' and ''guarantee issued by a non-controlled person'' to include sponsors of special purpose entities.[56] The effect of such an amendment would be to permit a fund holding an ABS to include any sponsor-provided demand feature or guarantee in the twenty-five percent basket.[57]

d. Asset Backed Securities: Other Issues

Some types of ABSs may consist of qualifying assets whose cash flow has been ''swapped'' to a financial institution that ultimately acts as the primary source of payment to funds holding the ABSs. In these circumstances, it may be appropriate for the fund to treat the financial institution as the issuer of the ABSs under the rule's diversification tests, because the fund is relying on the creditworthiness of that institution. Comment is requested on whether and how the rule should be amended to address swaps and similar arrangements.

4. Other Proposed Amendments

a. Definition of Eligible Security—Certain Unrated Securities

Rule 2a–7 provides that an unrated security that, when issued was a long-term security but when purchased by the fund had a remaining maturity of less than 397 calendar days, may be considered to be an eligible security based on whether the security is comparable in quality to a rated security, unless the security has received a long-term rating from any NRSRO that is not within the three highest categories of long-term ratings.[58] Proposed amendments to the rule permit a fund to treat such a security as an eligible security if that security had a long-term rating from the requisite NRSROs [59] within the three highest rating categories.[60]

b. Acquisition of Portfolio Securities

Several provisions of the rule that are applicable to the purchase of portfolio securities refer to the purchase or

[50] Paragraphs (c)(4)(ii)(D)(*1*) and (c)(4)(D)(ii)(*2*) of rule 2a–7, as proposed to be amended. The proposed amendments reflect the approach illustrated in materials prepared by the staff of the Division of Investment Management. *See* Materials for 1996 ICI Conference on Money Market Fund Regulation: Asset Backed Securities and Synthetic Securities—Application of Paragraph (c)(4)(vi)(A)(*4*) of Rule 2a–7 (May 9, 1996) (copies available upon request). Some industry participants have urged that the rule's diversification requirements be amended to require money market funds to look through to the receivables underlying asset backed securities, and have maintained that a fund holding an asset backed security is exposed only to the credit quality of the ultimate obligors and not the special purpose entity. The Commission is not proposing to follow this approach for several reasons. First, the status of an ABS as an eligible investment for a money market fund is not based on the creditworthiness of each obligor, but rather on the creditworthiness of the entire pool of assets, which typically is evaluated and rated based on the actuarial experience of similar pools with similar features (such as an overcollateralization). Second, applying the rule's diversification tests to the ultimate obligors of an ABS could permit a fund to invest a significant percentage of its total assets in a single ABS. Third, the suggested approach would create significant administrative burdens on funds that purchase ABSs, because the funds would have to identify and monitor *each* obligor (or each guarantor of each obligor), and determine whether the value of these obligations, together with any other securities issued by that obligor that the funds hold directly or propose to acquire, would exceed the applicable diversification requirements.

[51] Paragraph (c)(4)(ii)(D)(3) of rule 2a–7, as proposed to be amended.

[52] For example, a fund could invest fifty percent of its total assets in ABSs issued by a special purpose entity whose qualifying assets consist of the obligations of ten individual ten percent obligors. Under the rule's diversification tests, each ten percent obligor would be deemed to be the issuer of five percent of the fund's total assets [(ten percent obligation) x (fifty percent investment)]. This result would be technically consistent with the diversification provisions of the rule, even though such an investment would expose fifty percent of the fund's total assets to the structural risk inherent in the special purpose entity issuing the ABSs.

[53] The diversification standards applicable to puts under rule 2a–7 apply with respect to seventy-five percent of a fund's total assets—a fund need not comply with the rule's put diversification standards with respect to the remaining twenty-five percent of its total assets (''twenty-five percent basket'') as long as: (1) the fund holds securities in the basket that are subject to, or issued by, providers of puts that are first tier securities; and (2) the puts held in the basket are puts issued by non-controlled persons. *See* paragraphs (a)(17) (definition of ''put issued by a non-controlled person'') and (c)(4)(v) of rule 2a–7.

[54] Section 2(a)(9) of the 1940 Act defines ''control'' to mean the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company. Any person who owns beneficially, either directly or through one or more controlled companies, more than twenty-five per centum of the voting securities of a company is presumed to control such company.

[55] Release 21837, *supra* note 1, at Section II.C.1.b.

[56] Paragraphs (a)(9) and (a)(15) of rule 2a–7, as proposed to be amended.

[57] Another effect would be that a sponsor-provided guarantee would be subject to the rating requirement for guarantees. *See supra* Section I.B.1.c of this Release (a guarantee issued by a non-controlled person is subject to the rating requirement described therein).

[58] Paragraph (a)(9)(iii)(B) of rule 2a–7.

[59] The term ''requisite NRSROs'' is defined in paragraph (a)(19) of rule 2a–7 (paragraph (a)(20) of rule 2a–7, as proposed to be amended) to 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 class of debt obligations of an issuer at the time the fund purchases or rolls over the security, that NRSRO.

[60] Paragraph (a)(10)(ii)(A) of rule 2a–7, as proposed to be amended. To eliminate duplicative text in the definitions of ''eligible security,'' ''first tier security'' and ''unrated security,'' the proposed amendments would delete subparagraph (ii) from each definition. See paragraphs (a)(10), (a)(12) and (a)(27) of rule 2a–7, as proposed to be amended.

''rollover'' of the security;[61] some refer only to the purchase[62] or acquisition[63] of a security by the fund.[64] To make the rule more uniform, and to clarify that the failure of a fund to exercise a demand feature does not have similar consequences under the rule as a decision to rollover commercial paper, the proposed amendments would add to the rule the defined term ''acquisition,'' which would include a rollover of a security (but not the exercise of a demand feature.)[65]

c. Single State Funds

The March Amendments provide that a single state fund is limited to investing no more than five percent of its assets in the securities of a single issuer (other than Government securities), but only with respect to seventy-five percent of its total assets. The remaining twenty-five percent of a single state fund's assets (''twenty five percent basket'') may be invested in the securities of one or more issuers, provided they are first tier securities.[66] The March Amendments define a single state fund as a tax exempt fund that holds itself out as primarily distributing income exempt from the income taxes of a specified state or locality.[67] Since the adoption of the March Amendments, the Commission has become aware that a few money market funds whose investment objectives are to distribute income exempt from the income taxes of a particular state cannot hold themselves out as single state funds because they may not primarily distribute such income. The proposed amendments would modify the current definition by permitting a fund to qualify as a single state fund, and make use of the twenty-five percent basket, if it holds itself out as seeking to maximize the amount of its distributed income that is exempt from the income taxes or other taxes on investments of a particular state.[68]

d. Standby Commitments

Under the rule, a ''standby commitment'' is defined as a put that entitles the holder to same day settlement,[69] and may be purchased by the fund only if the board (or its delegate) finds that the issuer presents minimal credit risks.[70] The Commission is proposing to delete the definition of ''standby commitment'' and all references thereto from the rule. Changes to other definitions make the use of this term in the rule unnecessary; a standby commitment that falls within the definition of a demand feature would be treated as a demand feature under the rule. Standby commitments that do not fall within the definition of demand feature could not act as a substitute for the credit quality, and could not be relied upon to shorten the maturity of the security, would not expose the fund to any significant risks with respect to the issuer of the standby commitment, and thus would not be subject to any of the rule's quality or diversification requirements.[71] Comment is requested on the proposed amendment.

e. Downgrades, Defaults and Other Events

Proposed amendments to rule 2a–7 would clarify that a fund's investment adviser (or other person) is required to reassess whether an unrated security or a second tier security continues to present minimal credit risks to the fund when it becomes aware that the security has been downgraded by any NRSRO below that NRSRO's two highest short-term rating categories.[72] This amendment would eliminate any confusion caused by the language of the rule, as amended by the March Amendments, that some industry participants have suggested could be read to require such a reassessment upon assignment of any rating below the two highest rating categories, whether short-term or long-term.

f. Recordkeeping Requirements

The Commission is proposing amendments to the rule's recordkeeping and procedural requirements. First, the proposed amendments would replace certain rule text inadvertently omitted and restore the requirement that a fund's board of directors (or its delegate) document the minimal credit risk determination with respect to all securities in the fund's portfolio.[73] Second, the proposed amendments would clarify that a fund would not be required to establish procedures concerning demand features and guarantees not relied upon if it does not hold such instruments.[74] Finally, proposed amendments to the procedures concerning these securities reflect modifications to the diversification test for asset backed securities.[75]

g. Investment Companies Holding Themselves Out as Money Market Funds

Paragraph (b) of rule 2a–7 provides that it is ''an untrue statement of material fact'' for a registered investment company to use ''money market'' or a similar term as part of its name, or to hold itself out to investors as a money market fund or its equivalent unless the fund meets the risk-limiting conditions of rule 2a–7. Proposed amendments to paragraph (b) of the rule would restate, using additional rulemaking authority recently provided to the Commission,[76] the rule's prohibition on the use of a name by an investment company that would suggest the company is a money market fund, unless that company is a money market fund that operates in compliance with the rule.[77]

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[61] See, e.g., paragraph (a)(19) of rule 2a–7 (definition of ''requisite NRSROs'').

[62] See, e.g., paragraph (c)(3)(iii) of rule 2a–7 (securities subject to conditional demand features).

[63] See, e.g., paragraphs (c)(3)(i) (portfolio quality—general); (c)(4)(i) (issuer diversification—taxable and national funds); (c)(4)(ii) (issuer diversification—single state funds); (c)(4)(v) (put diversification); and (c)(5)(i)(A)(*2*) (downgrade of unrated security or second tier security held by the fund) of rule 2a–7.

[64] See also paragraph (c)(4)(iv) of rule 2a–7 (diversification tests applicable to second tier securities—references to ''acquisition'' and ''rollover'' but not to ''purchase'').

[65] Paragraph (a)(1) of rule 2a–7, as proposed to be amended.

[66] Paragraph (c)(4)(ii) of rule 2a–7.

[67] Paragraph (a)(21) of rule 2a–7.

[68] Paragraph (a)(22) of rule 2a–7, as proposed to be amended.

[69] Paragraph (a)(22) of rule 2a–7.

[70] Paragraph (a)(9)(iii)(A) of rule 2a–7.

[71] In the 1985 release proposing amendments to rule 2a–7, the Commission explained that a fund usually pays nothing or only a nominal consideration for a standby commitment, and the commitment may be ''exercised only as a last resort, because the broker, dealer, or other financial institution [providing the standby commitment] would suffer a loss on the transaction if the exercise price is greater than the market value of the underlying securities at the time of exercise.'' Acquisition and Valuation of Certain Portfolio Instruments by Registered Investment Companies, Investment Company Act Release No. 14607 (July 1, 1985) (50 FR 27982 (July 9, 1985)). If there is a practical, contractual or other impediment to its exercise, a standby commitment would not be a ''demand feature'' under rule 2a–7 because it is not readily exercisable at the time intervals specified in paragraph (a)(7) of the rule.

[72] Paragraph (c)(6)(i)(A)(*2*) of rule 2a–7, as proposed to be amended.

[73] Paragraph (c)(10)(iii) of rule 2a–7, as proposed to be amended.

[74] Paragraph (c)(9)(ii) of rule 2a–7, as proposed to be amended.

[75] Paragraphs (c)(9)(iv) and (c)(10)(v) of rule 2a–7, as proposed to be amended.

[76] The National Securities Markets Improvement Act of 1996 (Pub. L. No. 104–290) amended Section 35(d) of the 1940 Act to provide that ''[i]t shall be unlawful for any registered investment company to adopt as a part of the name or title of such company, or of any securities of which it is the issuer, any word or words that the Commission finds are materially deceptive or misleading. The Commission is authorized, by rule or regulation, or order, to define such names and titles as are materially deceptive and misleading.''

[77] Paragraph (b) of rule 2a–7, as proposed to be amended.

II. Proposed Amendments to the Advertising Rules

The Commission is also proposing to amend the Commission's advertising rules to clarify the formula used by money market funds to calculate yield and to seek to ensure that investors are not confused by presentation of a money market fund's short-term total return in lieu of its yield.

A. Calculation of Yield

The Commission adopted a uniform method of calculating money market fund yield in 1980 that explicitly limited income reflected in yield to investment income.[78] In 1983, the Commission revised the formula to correct a flaw in the formula at which time the limitation on investment income was unintentionally omitted.[79] Recently, questions have been raised regarding the inclusion of income other than investment income in the advertised yield of a money market fund. To resolve such questions, the Commission is proposing to amend the formula to clarify that income included in yield is limited to investment income.[80]

B. Use of Total Return

Some money market funds, instead of advertising their performance by quoting a seven-day yield calculated in accordance with Commission rules, have used quotations of total return covering short periods of time. Even though sales material may properly identify the performance figure as ''total return,'' the Commission is concerned that many investors will not recognize the distinction or, if they do, will not appreciate the difference between total return and yield. As a result, investors may assume incorrectly that a fund quoting the higher total return figure is a better performing fund than the other money market funds quoting yield.[81] In addition, investors may incorrectly assume that the higher ''total return'' is the yield they can expect to receive upon an investment in the fund.

In seeking to ensure that the distinction between money market fund yields and short-term total return is clear, the Commission is proposing to amend rules 482 under the Securities Act of 1933 and 34b–1 under the 1940 Act to require that total return used in advertisements and sales literature cover a period of at least one year. In addition, the Commission is proposing to require that quotations of total return in advertisements and sales literature be accompanied by a quotation of current yield, computed in accordance with Commission rules, and set forth with equal prominence.

III. Request for Comment

In connection with its review of the rules and forms regulating money market funds, the staff has become aware of a fund sponsor that established a program linking a money market fund with a debit card available for use by the fund's shareholders. Under the program, rebates earned by the fund on credit card transactions entered into by the fund's shareholders are distributed to the shareholders in the form of income.[82] This type of income is not investment income and its inclusion in the money market fund's standardized yield is not permitted.[83] The Commission solicits comment on an appropriate method for disclosing, in connection with performance information, these rebate amounts and other types of arrangements involving non-investment income. For example, should a fund be able to advertise a separate rate of return (as a percentage) for the rebate feature covering the same period of time as the standardized yield?

IV. Transition Period

The release adopting the March Amendments provided that money market funds would be required to comply with certain of the amendments by October 3, 1996, which was approximately six months from the date of publication of the March Amendments in The Federal Register.[84] On August 13, 1996, the Commission suspended the compliance date for the March Amendments until the final version of these proposed amendments is published in The Federal Register.[85] Comment is requested on an appropriate compliance date for these technical amendments, and whether the release adopting these technical amendments should provide for a compliance period of comparable length to that of the March Amendments.

V. Cost/Benefit Analysis

The proposals discussed above constitute refinements to the rules regulating money market funds, and would not increase costs for money market funds, their advisers, or other market participants. The proposed technical amendments would clarify the application of the quality and diversification tests under rule 2a–7 consistent with investor protection. The Commission requests specific comment on its assessment of the costs and benefits associated with the proposal, including specific estimates of costs and benefits.

VI. Paperwork Reduction Act

Certain provisions of the proposed amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), and the Commission has submitted proposed amendments to the Office of Management and Budget for review in accordance with 44 U.S.C. 3507(d). The title for the collection of information is ''Rules Regulating Money Market Funds.'' The Supporting Statement to the Paperwork Reduction Act submission notes that, because the proposed technical amendments to rule 2a–7 would clarify existing reporting and recordkeeping obligations, it is estimated that they would have no effect on the annual reporting burden of money market funds. The Supporting Statement also notes that the proposed

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[78] Advertising by Investment Companies, Investment Company Act Release No. 11379 (Sept. 30, 1980) [45 FR 67079 (Oct. 9, 1980)].

[79] ''Money Market'' Funds' Inclusion of a Standardized Yield Computation in Prospectuses, Investment Company Act Release No. 13049 (Feb. 28, 1983) [48 FR 10297 (Mar. 11, 1983)]. In this release, the Commission stated that ''limiting the yield to net *investment income* better indicates the earning potential of a fund's portfolio and thus both promotes comparability of yield and reduces the potential for misleading investors.* * *'' (Emphasis added.)

[80] The proposed amendments would revise 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].

[81] This practice typically occurs during a period of declining interest rates when the fund's total return will be higher than its current yield because it will include periods of time during which the fund held higher yielding securities. It may also occur in order to avoid the limitation on income included in yield to investment income. *See* discussion supra.

[82] *See* Robert D. Hershy, Jr., *Sophia Collier, Soda Entrepreneur, Uncorks a Money Market Fund,* N.Y. Times, at sec. 3, p. 11.

[83] Such funds clearly can, however, for example, advertise the dollar value of the rebate, or specify the dollar amounts received per certain dollars invested in the fund over some stated period of time.

[84] Release 21837, supra note 1, at Section V.B.

[85] Compliance Date Release, *supra* note 4. The March Amendments clarified that floating rate and variable rate securities (''adjustable rate securities'') must reasonably be expected to have market values that approximate their amortized cost values on each interest rate adjustment date through their final maturity dates. *See* Release 21837, *supra* note 1, at Section II.F.4 and paragraphs (a)(12) and (a)(30) of rule 2a–7 (definitions of ''floating rate security'' and ''variable rate security''). Because these provisions of the March Amendments merely clarified the application of existing provisions of the rule, whether a fund or its adviser must reasonably expect the market value of an adjustable rate security to approximate its amortized cost value was not affected by the Compliance Date Release.

amendments to the advertising rules would not impose any new paperwork burden on money market funds because the majority of money market funds do not include income other than investment income in calculating their yield, and do not advertise total return based on short periods of time.

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments concerning: whether the proposed collection of information is necessary for the proper performance of the function of the Commission, including whether the information shall have practical utility; on the accuracy of the Commission's estimate of the burden of the proposed collection of information; on the quality, utility, and clarity of the information to be collected; and whether the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information or technology, may be minimized.

Persons desiring to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549 with reference to File No. S7–29–96. The Office of Management and Budget is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to the Office of Management and Budget is best assured of having its full effect if the Office of Management and Budget receives it within 30 days of publication.

VII. Summary of Initial Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis in accordance with 5 U.S.C. 603 regarding proposed technical amendments to rule 2a–7, and proposed amendments to the advertising rules applicable to money market funds. The analysis states that the proposed technical amendments to rule 2a–7 are not intended to effect major substantive changes to the rule, but are designed to codify interpretive positions taken by the staff of the Division of Investment Management; revise terminology in the rule to reflect common usage; modify certain of the March Amendments so that the treatment accorded certain instruments by rule 2a–7 more closely reflects the treatment accorded to those instruments by the financial markets; and make certain other technical corrections. The analysis also states that, in light of the nature of the proposed technical amendments to the rule, it would be inconsistent with the purposes of the Regulatory Flexibility Act to propose to exempt small entities from the coverage of these amendments.

The analysis also discusses the proposed amendments to the advertising rules for money market funds. The analysis explains that the proposed amendments are designed to clarify the formula used by money market funds to calculate yield and to prevent investors from being confused or misled by the presentation of a money market fund's short-term total return in lieu of its yield. The analysis states that the concerns that caused the Commission to undertake this proposed rulemaking are equally applicable to funds of all sizes. A copy of the Initial Regulatory Flexibility Analysis may be obtained by contacting Marjorie S. Riegel, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 10–6, Washington, DC 20549.

VIII. 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 proposing to amend 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, 78d, 78*l*, 78m, 78n, 78o, 78w, 79*ll*(d), 79t, 80a–8, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

2. Section 230.482 is amended by revising paragraph (d) to read as follows:

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

* * * * *

(d) In the case of a money market fund:

(1) Any quotation of the money market fund's yield in an advertisement shall be:

(i) A quotation of current yield based on the method of computation prescribed in Form N–1A (§§ 239.15A and 274.11A of this chapter), Form N–3 (§§ 239.17a and 274.11b of this chapter), or Form N–4 (§§ 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

(ii) A quotation of current yield described in paragraph (d)(1)(i) of this section and a corresponding quotation of effective yield based on the method of computation prescribed in Form N–1A (§§ 239.15A and 274.11A of this chapter), Form N–3 (§§ 239.17a and 274.11b of this chapter), or Form N–4 (§§ 239.17b and 274.11c of this chapter); 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; and

(2) Any quotation of total return shall cover a period of no less than one year and shall be accompanied by a quotation of the fund's current yield described in paragraph (d)(1)(i) of this section.

* * * * *

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

3. The authority citation for part 270 is amended by revising the general authority as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(b), 80a-37, 80a-39 unless otherwise noted;

* * * * *

4. Section 270.2a-7 is revised to read as follows:

§ 270.2a-7 Money market funds.

(a) *Definitions.* (1) *Acquisition* (or *Acquire*) shall mean any purchase or subsequent rollover (but does not include the failure to exercise a Demand Feature).

(2) *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.

(3) *Asset Backed Security* shall mean a fixed income security (other than a Government security) issued by a Special Purpose Entity (as defined in this paragraph), substantially all of the assets of which consist of Qualifying Assets (as defined in this paragraph). *Special Purpose Entity* shall mean a trust, corporation, partnership or other entity organized for the sole purpose of

issuing securities which entitle their holders to receive payments that depend primarily on the cash flow from Qualifying Assets, but does not include a registered investment company. *Qualifying Assets* shall mean financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders.

(4) *Business Day* shall mean any day, other than Saturday, Sunday, or any customary business holiday.

(5) *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 (as defined in paragraph (a)(5(v) provided in the agreement;

(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;

(iii) The collateral consists entirely of cash items, Government Securities or other securities that at the time the repurchase agreement is entered into are rated in the highest rating category by the Requisite NRSROs; and

(iv) Upon an event of insolvency with respect to the seller, the repurchase agreement would qualify under a provision of applicable insolvency law providing an exclusion from any general stay of creditors' rights against the seller.

(v) *Resale Price* shall mean the Acquisition price paid to the seller of the securities plus the accrued resale premium on such Acquisition price. The accrued resale premium shall be the amount specified in the repurchase agreement or the daily amortization of the difference between the Acquisition price and the resale price specified in the repurchase agreement.

(6) *Conditional Demand Feature* shall mean a Demand Feature that is not an Unconditional Demand Feature. A Conditional Demand Feature is not a Guarantee.

(7) *Conduit Security* shall mean a security issued by a Municipal Issuer (as defined in this paragraph) involving an arrangement or agreement entered into, directly or indirectly, with a person other than a Municipal Issuer, which arrangement or agreement provides for or secures repayment of the security. *Municipal Issuer* shall mean a state or territory of the United States (including the District of Columbia), or any political subdivision or public instrumentality of a state or territory of the United States. A Conduit Security *does not* include a security that is:

(i) Fully and unconditionally guaranteed by a Municipal Issuer; or

(ii) Payable from the general revenues of the Municipal Issuer or other Municipal Issuers (other than those revenues derived from an agreement or arrangement with a person who is not a Municipal Issuer that provides for or secures repayment of the security issued by the Municipal Issuer); or

(iii) Related to a project owned and operated by a Municipal Issuer; or

(iv) Related to a facility leased to and under the control of an industrial or commercial enterprise that is part of a public project which, as a whole, is owned and under the control of a Municipal Issuer.

(8) *Demand Feature* shall mean:

(i) A feature permitting the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the time of exercise. A Demand Feature must be exercisable either:

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

(B) At specified intervals not exceeding 397 calendar days and upon no more than 30 calendar days' notice; or

(ii) A feature permitting the holder of an Asset Backed Security unconditionally to receive principal and interest within 397 calendar days of making demand.

(9) *Demand Feature Issued By A Non-Controlled Person* shall mean a Demand Feature issued by a person that, directly or indirectly, does *not* control, and is not controlled by or under common control with the issuer of the security subject to the Demand Feature; and a sponsor of an Asset Backed Security with respect to an Asset Backed Security. *Control* shall mean ''control'' as defined in section 2(a)(9) of the Act (15 U.S.C. 80a-2(a)(9)).

(10) *Eligible Security* shall mean:

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

(ii) An Unrated Security that is of comparable quality to a security meeting the requirements of paragraph (a)(10)(i) of this section, as determined by the money market fund's board of directors; *Provided, however,* that:

(A) A security that at the time of issuance had a remaining maturity of more than 397 calendar days 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 received a long-term rating from any NRSRO that is not within the NRSRO's three highest long-term ratings categories (within which there may be sub-categories or gradations indicating relative standing) unless the security has received a long-term rating from the Requisite NRSROs in one of the three highest rating categories;

(B) An Asset Backed Security (other than an Asset Backed Security substantially all of whose Qualifying Assets consist of obligations of one or more Municipal Issuers, as that term is defined in paragraph (a)(7) of this section) shall not be an Eligible Security unless it has received a rating from an NRSRO.

(iii) In addition, in the case of a security that is subject to a Demand Feature or Guarantee:

(A) The Guarantee has received a rating or is issued by an issuer that has received a rating from an NRSRO (unless the Guarantee is issued by a person that, directly or indirectly, controls, is controlled by or is under common control with the issuer of the security subject to the Guarantee); and

(B) The issuer of the Demand Feature or Guarantee, or another institution, has undertaken promptly to notify the holder of the security in the event the Demand Feature or Guarantee is substituted with another Demand Feature or Guarantee (if such substitution is permissible under the terms of the Demand Feature or Guarantee).

(11) *Event of Insolvency* shall mean, with respect to a person:

(i) An admission of insolvency, the application by the person for the appointment of a trustee, receiver, rehabilitator, or similar officer for all or substantially all of its assets, a general assignment for the benefit of creditors, the filing by the person of a voluntary petition in bankruptcy or application for reorganization or an arrangement with creditors; or

(ii) The institution of similar proceedings by another person which proceedings are not contested by the person; or

(iii) The institution of similar proceedings by a government agency responsible for regulating the activities of the person, whether or not contested by the person.

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

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

(ii) Is an Unrated Security that is of comparable quality to a security meeting the requirements of paragraph (a)(12)(i) of this section, as determined by the fund's board of directors; or

(iii) Is a security issued by a registered investment company that is a money market fund; or

(iv) Is a Government Security.

(13) *Floating Rate Security* shall mean a security the terms of which provide for the adjustment of its interest rate whenever a specified interest rate changes and which, at any time until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

(14) *Guarantee* shall mean an unconditional obligation of a person other than the issuer of the security to undertake to pay, upon presentment by the holder of the Guarantee (if required), at a specified time a price equal to the principal amount of the underlying security plus accrued interest when due or upon default, or, in the case of an Unconditional Demand Feature, an obligation that entitles the holder to receive upon exercise the approximate amortized cost of the underlying security or securities, plus accrued interest, if any. A Guarantee includes a letter of credit, financial guaranty (bond) insurance, and an Unconditional Demand Feature (other than an Unconditional Demand Feature provided by the issuer of the security).

(15) *Guarantee Issued by a Non-Controlled Person* shall mean a Guarantee issued by a person that, directly or indirectly, does *not* control, and is not controlled by or under common control with the issuer of the security subject to the Guarantee; and a sponsor of a Special Purpose Entity with respect to an Asset Backed Security. *Control* shall mean ''control'' as defined in section 2(a)(9) of the Act (15 U.S.C. 80a–2(a)(9)).

(16) *Government Security* shall mean any Government security as defined in section 2(a)(16) of the Act (15 U.S.C. 80a–2(a)(16)).

(17) *NRSRO* shall mean any nationally recognized statistical rating organization, as that term is used in paragraphs (c)(2)(vi) (E), (F) and (H) of § 240.15c3–1 of this chapter 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, or provider of credit support for, the security.

(18) *Penny-Rounding Method* of pricing shall mean the method of computing an investment company's price per share for purposes of distribution, redemption and repurchase whereby the current net asset value per share is rounded to the nearest one percent.

(19) *Refunded Security* shall mean a debt security the principal and interest payments of which are to be paid by Government Securities (''deposited securities'') that have been irrevocably placed in an escrow account pursuant to agreement between the issuer of the debt security and an escrow agent 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 the debt security, and, in accordance with such escrow agreement, are pledged only to the payment of the debt security and, to the extent that excess proceeds are available after all payments of principal, interest, and applicable premiums on the Refunded Securities, the expenses of the escrow agent and, thereafter, to the issuer or another party; *provided* that:

(i) The deposited securities shall not be redeemable prior to their final maturity;

(ii) The escrow agreement shall prohibit the substitution of the deposited securities unless the substituted securities are Government Securities; and

(iii) At the time the deposited securities are placed in the escrow account, or at the time a substitution of the deposited securities is made, an independent certified public accountant shall have certified to the escrow agent that the deposited securities will satisfy all scheduled payments of principal, interest and applicable premiums on the Refunded Securities; *Provided, however*, an independent public accountant need not have provided the certification described herein if the security, as a Refunded Security, has received a rating from an NRSRO in the highest category for debt obligations (within which there may be sub-categories or gradations including relative standing).

(20) *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 class of debt obligations of an issuer at the time the fund Acquires the security, that NRSRO.

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

(22) *Single State Fund* shall mean a Tax Exempt Fund that holds itself out as seeking to maximize the amount of its distributed income that is exempt from the income taxes or other taxes on investments of a particular state and, where applicable, subdivisions thereof.

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

(24) *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.

(25) *Unconditional Demand Feature* shall mean a Demand Feature 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.

(26) *United States Dollar-Denominated* shall mean, with reference to a security, that all principal and interest payments on such security are payable to security holders in United States dollars under all circumstances and that the interest rate of, the principal amount to be repaid, and the timing of payments related to such security do not vary or float with the value of a foreign currency, the rate of interest payable on foreign currency borrowings, or with any other interest rate or index expressed in a currency other than United States dollars.

(27) *Unrated Security* shall mean:

(i) A security with a remaining maturity of 397 calendar days or less issued by an issuer that did not, at the time the security was Acquired by the fund, have a current short-term rating assigned by any NRSRO:

(A) To the security; or

(B) To the issuer of the security with respect to a class of debt obligations (or

any debt obligation within that class) that is comparable in priority and security with the security, or a Demand Feature with respect to the security; and

(ii) A security that is a rated security and is the subject of an external credit support agreement (including an arrangement by which the security has become a Refunded Security) that was not in effect when the security (or the issuer) was assigned its rating unless the security has a rating from an NRSRO reflecting the existence of the credit support agreement.

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

(28) *Variable Rate Security* 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 each adjustment until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.

(b) *Holding Out and Use of Names and Titles.* (1) 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 hold itself out to investors as 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.

(2) It shall constitute the use of a materially deceptive or misleading name or title within the meaning of section 35(d) of the Act [15 U.S.C. 80a–34(d)] for a registered investment company to adopt the term ''money market'' as part of its name or title or the name or title of any redeemable securities of which it is the issuer, or to 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.

(3) 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 §§ 270.2a–4 and 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, acquire 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, acquire 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*—(i) *General.* The money market fund shall limit its portfolio investments to those United States Dollar-Denominated securities that the fund's board of directors determines present minimal credit risks (which determination must be based on factors pertaining to credit quality in addition to any rating assigned to such securities by an NRSRO) and which are at the time of Acquisition Eligible Securities.

(ii) *Second Tier Securities.* Immediately after the Acquisition of any Second Tier Security:

(A) *Taxable Funds.* A money market fund that is not a Tax Exempt Fund shall not have invested more than Five Percent of its Total Assets in securities which are Second Tier Securities; and

(B) *Tax Exempt Funds.* A money market fund that is a Tax Exempt Fund shall not have invested more than Five Percent of its Total Assets in Conduit Securities which are Second Tier Conduit Securities.

(iii) *Securities Subject to Guarantees.* A security that is subject to a Guarantee may be determined to be an Eligible Security or a First Tier Security based solely on whether the Guarantee is an Eligible Security or First Tier Security, as the case may be.

(iv) *Securities Subject to Conditional Demand Features.* A security that is subject to a Conditional Demand Feature (''Underlying Security'') may be determined to be an Eligible Security or a First Tier Security only if:

(A) The Conditional Demand Feature is an Eligible Security or First Tier Security, as the case may be; and

(B) At the time of the Acquisition of the Underlying Security, the money market fund's board of directors has determined that there is minimal risk that the circumstances that would result in the Conditional Demand Feature not being exercisable will occur; and

(*1*) The conditions limiting exercise either can be monitored readily by the fund, or relate to the taxability, under federal, state or local law, of the interest payments on the security; or

(*2*) The terms of the Conditional Demand Feature require that the fund will receive notice of the occurrence of the condition and the opportunity to exercise the Demand Feature in accordance with its terms; and

(C) The Underlying Security or any Guarantee of such security (or the debt securities of the issuer of the Underlying Security or Guarantee that are comparable in priority and security with the Underlying Security or Guarantee) has received either a short-term rating or a long-term rating, as the case may be, by the Requisite NRSROs within the NRSROs' two highest short-term or long-term rating categories (within which there may be sub-categories or gradations indicating relative standing) or, if unrated, is determined to be of comparable quality by the money market fund's board of directors to a security that has received a rating from the Requisite NRSROs within the NRSRO's two highest short-term or long-term rating categories, as the case may be.

(4) *Portfolio Diversification*—(i) *Issuer Diversification.* The money market fund shall be diversified with respect to issuers of securities Acquired by the fund as provided in paragraphs (c)(4)(i) and (c)(4)(ii) of this section, other than with respect to Government Securities and securities subject to a Guarantee Issued By A Non-Controlled Person.

(A) *Taxable and National Funds.* Immediately after the Acquisition of any security, a money market fund other than a Single State 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 such a fund may invest up to twenty-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 Acquisition thereof, *Provided, Further,* that the fund may not invest in the securities of more than one issuer in accordance with the foregoing proviso in this paragraph at any time.

(B) *Single State Funds.* With respect to seventy-five percent of its Total Assets, immediately after the Acquisition of any security, a Single State 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 Single State Fund shall not invest more than five percent of its Total Assets in securities issued by the issuer of the security unless the securities are First Tier Securities.

(C) *Second Tier Securities*—(*1*) *Taxable Funds.* Immediately after the Acquisition of any Second Tier Security, a money market fund that is not a Tax Exempt Fund shall not have invested more than the greater of one percent of its Total Assets or one million dollars in securities issued by that issuer which are Second Tier Securities.

(*2*) *Tax Exempt Funds.* Immediately after the Acquisition of any Second Tier Conduit Security, a money market fund that is a Tax Exempt Fund shall not have invested more than the greater of one percent of its Total Assets or one million dollars in securities issued by that issuer which are Second Tier Conduit Securities.

(ii) *Issuer Diversification Calculations.* For purposes of making calculations under paragraph (c)(4)(i) of this section:

(A) *Repurchase Agreements.* The Acquisition of a repurchase agreement may be deemed to be an Acquisition of the underlying securities, provided the obligation of the seller to repurchase the securities from the money market fund is Collateralized Fully.

(B) *Refunded Securities.* The Acquisition of a Refunded Security shall be deemed to be an Acquisition of a Government Security.

(C) *Conduit Securities.* A Conduit Security shall be deemed to be issued by the issuer (other than the Municipal Issuer) ultimately responsible for payments of interest and principal on the security.

(D) *Asset Backed Securities*—(*1*) *General.* An Asset Backed Security shall be deemed to be issued by the Special Purpose Entity that issued the Asset Backed Security, *Provided, however,* any person whose obligations constitute ten percent or more of the principal amount of the Qualifying Assets of that Special Purpose Entity (''Ten Percent Obligor'') shall be deemed to be an issuer of the portion of the Asset Backed Security such obligations represent; and

(*2*) *Secondary Asset Backed Securities.* If the Ten Percent Obligor is itself a Special Purpose Entity issuing Asset Backed Securities (''Secondary ABS''), then that obligor shall be deemed to have issued a portion of the assets of the primary Asset Backed Security that such Secondary ABS represents. For purposes of identifying Ten Percent Obligors, continue down the chain of Ten Percent Obligors until a Special Purpose Entity with no Ten Percent Obligor is reached.

(*3*) *Demand Features and Guarantees.* In the case of a Ten Percent Obligor deemed to be an issuer, the fund shall satisfy the diversification requirements of paragraph (c)(4)(iii) of this section with respect to any Demand Feature or Guarantee to which the Ten Percent Obligor's obligations are subject.

(E) *Shares in Master Funds.* A money market fund substantially all of the assets of which consist of shares of another money market fund Acquired in reliance on section 12(d)(1)(E) of the Act (15 U.S.C. 80a–12(d)(1)(E)) shall be deemed to be in compliance with this section if the board of directors of the money market fund holding the assets of another money market fund reasonably believes that the fund in which it has invested is in compliance with this section.

(iii) *Diversification Rules for Demand Features and Guarantees.* The money market fund shall be diversified with respect to Demand Features and Guarantees Acquired by the fund as provided in paragraphs (c)(4)(iii) and (c)(4)(iv) of this section, other than with respect to a Demand Feature issued by the same institution that issued the underlying security.

(A) *General.* Immediately after the Acquisition of any Demand Feature or Guarantee or security subject to a Demand Feature or Guarantee, a money market fund, with respect to seventy-five percent of its Total Assets, shall not have invested more than ten percent of its Total Assets in securities issued by or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee, subject to paragraphs (c)(4)(iii) (B) and (C) of this section.

(B) *Second Tier Demand Features or Guarantees.* Immediately after the Acquisition of any Demand Feature or Guarantee (or a security after giving effect to the Demand Feature or Guarantee) that is a Second Tier Security, a money market fund shall not have invested more than five percent of its Total Assets in securities issued by or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee.

(C) *Demand Features or Guarantees Issued by Non-Controlled Persons.* Immediately after the Acquisition of any security subject to a Demand Feature or Guarantee, a money market fund shall not have invested more than ten percent of its Total Assets in securities issued by, or subject to Demand Features or Guarantees from the institution that issued the Demand Feature or Guarantee, unless, with respect to any security subject to Demand Features or Guarantees from that institution (other than securities issued by such institution), the Demand Feature or Guarantee is a Demand Feature or Guarantee Issued By A Non-Controlled Person.

(iv) *Demand Feature and Guarantee Diversification Calculations*—(A) *Fractional Demand Features or Guarantees.* In the case of a security subject to a Demand Feature or Guarantee from an institution by which the institution guarantees a specified portion of the value of the security, the institution shall be deemed to guarantee the specified portion thereof, *Provided, however,* if the security is an Asset Backed Security and the Demand Feature or Guarantee is with respect to all or a portion of the first losses with respect to the security, the institution providing the Demand Feature or Guarantee shall be deemed to have provided the Demand Feature or Guarantee with respect to the entire principal amount of the security.

(B) *Layered Demand Features or Guarantees.* In the case of a security subject to Demand Features or Guarantees from multiple institutions that have not limited the extent of their obligations as described in paragraph (c)(4)(iv)(A) of this section, each institution shall be deemed to have

provided the Demand Feature or Guarantee with respect to the entire principal amount of the security.

(v) *Diversification Safe Harbor.* A money market fund that satisfies the applicable diversification requirements of paragraph (c)(4) of this section shall be deemed to have satisfied the diversification requirements of section 5(b)(1) of the Act (15 U.S.C. 80a–5(b)(1)) and the rules adopted thereunder.

(5) *Demand Features and Guarantees Not Relied Upon.* If the fund's board of directors has determined that the fund is not relying on a Demand Feature or Guarantee to determine the quality (pursuant to paragraph (c)(3) of this section), or maturity (pursuant to paragraph (d) of this section), or liquidity of a portfolio security, and maintains a record of this determination (pursuant to paragraphs (c)(9)(ii) and (c)(10)(vi) of this section), then the fund may disregard such Demand Feature or Guarantee for all purposes of this section.

(6) *Downgrades, Defaults and Other Events*—(i) *Downgrades*—(A) *General.* Upon the occurrence of either of the events specified in paragraphs (c)(6)(i)(A)(*1*) and (*2*) of this section with respect to a portfolio security, the board of directors of the money market fund shall reassess promptly whether such security continues to present minimal credit risks and shall cause the fund to take such action as the board of directors determines is in the best interests of the money market fund and its shareholders:

(*1*) 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); and

(*2*) The money market fund's investment adviser (or any person to whom the 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 short-term rating category.

(B) *Securities To Be Disposed of.* The reassessments required by paragraph (c)(6)(i)(A) of this section shall not be 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 specified event and, in the case of events specified in paragraph (c)(6)(i)(A)(*2*) of this section, the board is subsequently notified of the adviser's actions.

(C) *Special Rule for Certain Securities Subject to Demand Features.* In the event that after giving effect to a rating downgrade, more than five percent of the fund's Total Assets are invested in securities issued by or subject to Demand Features from a single institution that are Second Tier Securities, the fund shall reduce its investment in securities issued by or subject to Demand Features from that institution to no more than five percent of its Total Assets by exercising the Demand Features at the next succeeding exercise date(s), 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.

(ii) *Defaults and Other Events.* Upon the occurrence of any of the events specified in paragraphs (c)(6)(ii)(A) through (D) of this section with respect to a portfolio 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, 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 portfolio security):

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

(B) A portfolio security ceases to be an Eligible Security;

(C) A portfolio security has been determined to no longer present minimal credit risks; or

(D) An Event of Insolvency occurs with respect to the issuer of a portfolio security or the provider of any Demand Feature or Guarantee.

(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) or an Event of Insolvency with respect to the issuer of the security or any Demand Feature or Guarantee to which it is subject, where immediately before default the securities (or the securities subject to the Demand Feature or Guarantee) 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.

(iv) *Defaults for Purposes of Paragraphs (c)(6)(ii) and (iii).* For purposes of paragraphs (c)(6) (ii) and (iii) of this section, an instrument subject to a Demand Feature or Guarantee shall not be deemed to be in default (and an Event of Insolvency with respect to the security shall not be deemed to have occurred) if:

(A) In the case of an instrument subject to a Demand Feature, the Demand Feature has been exercised and the fund has recovered either the principal amount or the amortized cost of the instrument, plus accrued interest; or

(B) The provider of the Guarantee is continuing, without protest, to make payments as due on the instrument.

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

(i) *General.* 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) *Specific Procedures.* Included within the procedures adopted by the board of directors shall be the following:

(A) *Shadow Pricing.* Written procedures shall provide:

(*1*) 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;

(*2*) For the periodic review by the board of directors of the amount of the deviation as well as the methods used to calculate the deviation; and

(3) For the maintenance of records of the determination of deviation and the board's review thereof.

(B) *Prompt Consideration of Deviation.* In the event such deviation from the money market fund's amortized cost price per share exceeds ½ of 1 percent, the board of directors shall promptly consider what action, if any, should be initiated by the board of directors.

(C) *Material Dilution or Unfair Results.* 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 or 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.

(8) *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.

(9) *Specific Procedures: Amortized Cost and Penny-Rounding Methods.* Included within the procedures adopted by the board of directors for money market funds using either the amortized cost or penny-rounding methods shall be the following:

(i) *Securities for Which Maturity Is Determined by Reference to Demand Features.* In the case of a security for which maturity is determined by reference to a Demand Feature, written procedures shall require ongoing review of the security's continued minimal credit risks, which review must be based on, among other things, financial data for the most recent fiscal year of the issuer of the Demand Feature and, in the case of a security subject to a Conditional Demand Feature, the issuer of the security whose financial condition must be monitored under paragraph (c)(3)(iv) of this section, whether such data is publicly available or provided under the terms of the security's governing documentation.

(ii) *Securities Subject to Demand Features or Guarantees.* In the case of a security subject to one or more Demand Features or Guarantees which the fund's board of directors has determined that the fund is not relying on to determine the quality (pursuant to paragraph (c)(3) of this section), maturity (pursuant to paragraph (d) of this section) or liquidity of the security subject to the Demand Feature or Guarantee, written procedures shall require periodic evaluation of such determination.

(iii) *Adjustable Rate Securities Without Demand Features.* In the case of a Variable Rate or Floating Rate Security that does not have a Demand Feature and for which maturity is determined pursuant to paragraphs (d)(1), (d)(2) or (d)(4) of this section, written procedures shall require periodic review of whether the interest rate formula, upon readjustment of its interest rate, can reasonably be expected to cause the security to have a market value that approximates its amortized cost value.

(iv) *Asset Backed Securities.* In the case of an Asset Backed Security, written procedures shall require the fund to periodically determine the number of Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section) deemed to be the issuers of all or a portion of the Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section.

(10) *Record Keeping and Reporting*—(i) *Written Procedures.* For a period of not less than six years following the replacement of such procedures with new procedures (the first two years in an easily accessible place), a written copy of the procedures (and any modifications thereto) described in paragraphs (c)(6) through (c)(9) and (e) of this section shall be maintained and preserved.

(ii) *Board Considerations and Actions.* For a period of not less than six years (the first two years in an easily accessible place) a written record shall be maintained and preserved of the board of directors' considerations and actions taken in connection with the discharge of its responsibilities, as set forth in this section, to be included in the minutes of the board of directors' meetings.

(iii) *Credit Risk Analysis.* For a period of not less than three years from the date that the credit risks of a portfolio security were most recently reviewed, a written record of the determination that a portfolio security presents minimal credit risks and the NRSRO ratings (if any) used to determine the status of the security as an Eligible Security, First Tier Security or Second Tier Security shall be maintained and preserved in an easily accessible place.

(iv) *Determinations with Respect to Adjustable Rate Securities.* For a period of not less than three years from the date when the determination was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the determination required by paragraph (c)(9)(iii) of this section (that a Variable Rate or Floating Rate Security that does not have a Demand Feature and for which maturity is determined pursuant to paragraphs (d)(1), (d)(2) or (d)(4) of this section can reasonably be expected, upon readjustment of its interest rate at all times during the life of the instrument, to have a market value that approximates its amortized cost).

(v) *Determinations with Respect to Asset Backed Securities.* For a period of not less than three years from the date when the determination was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the determination required by paragraph (c)(9)(iv) of this section (the number of Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section) deemed to be the issuers of all or a portion of the Asset Backed Security for purposes of paragraph (c)(4)(iv)(D) of this section). The written record shall include the identities of the Ten Percent Obligors (as that term is used in paragraph (c)(4)(ii)(D) of this section), the percentage of the Qualifying Assets constituted by the securities of each Ten Percent Obligor and the percentage of the fund's Total Assets that are invested in securities of each Ten Percent Obligor.

(vi) *Evaluations with Respect to Securities Subject to Demand Features or Guarantees.* For a period of not less than three years from the date when the evaluation was most recently made, a written record shall be preserved and maintained, in an easily accessible place, of the evaluation required by paragraph (c)(9)(ii) (regarding securities subject to one or more Demand Features or Guarantees) of this section.

(vii) *Inspection of Records.* The documents preserved pursuant to this paragraph (c)(10) 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 under paragraphs (c)(6)(ii) (with respect to defaulted securities and events of

insolvency) or (c)(7)(ii) (with respect to a deviation from the fund's share price of more than ½ of 1 percent) of this section, the money market fund will file 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 Securities.* For purposes of this section, the maturity of a portfolio security 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 security is subject to market action) until the date on which, in accordance with the terms of the security, the principal amount must unconditionally be paid, or in the case of a security called for redemption, the date on which the redemption payment must be made, except as provided in paragraphs (d)(1) through (d)(8) of this section:

(1) *Adjustable Rate Government Securities.* A Government Security which is a Variable Rate Security where the variable rate of interest is readjusted no less frequently than every 762 calendar days shall be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate. A Government Security which is a Floating Rate Security shall be deemed to have a remaining maturity of one day.

(2) *Short-Term Variable Rate Securities.* A Variable Rate Security, the principal amount of which, in accordance with the terms of the security, must unconditionally be paid in 397 calendar days or less shall be deemed to have a maturity equal to the earlier 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.

(3) *Long-Term Variable Rate Securities.* A Variable Rate Security, the principal amount of which is scheduled to be paid in more than 397 calendar days, 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) *Short-Term Floating Rate Securities.* A Floating Rate Security, the principal amount of which, in accordance with the terms of the security, must unconditionally be paid in 397 calendar days or less shall be deemed to have a maturity of one day.

(5) *Long-Term Floating Rate Securities.* A Floating Rate Security, the principal amount of which is scheduled to be paid in more than 397 calendar days, 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.

(6) *Repurchase Agreements.* 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 the agreement is subject to demand, the notice period applicable to a demand for the repurchase of the securities.

(7) *Portfolio Lending Agreements.* 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 the agreement is subject to demand, the notice period applicable to a demand for the return of the loaned securities.

(8) *Money Market Fund Securities.* An investment in a money market fund shall be treated as having a maturity equal to the period of time within which the Acquired money market fund is required to make payment upon redemption, unless the Acquired money market fund has agreed in writing to provide redemption proceeds to the investing money market fund within a shorter time period, in which case the maturity of such investment shall be deemed to be the shorter period.

(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 paragraphs (c)(1) (board findings); (c)(6)(i)(C) (rule for certain securities subject to second tier Demand Features); (c)(6)(ii) (defaults and other events); (c)(7)(i) (general required procedures: Amortized Cost Method); (c)(7)(ii)(A) (shadow pricing), (B) (prompt consideration of deviation), and (C) (material dilution or unfair results); and (c)(8) (required procedures: Penny Rounding Method) of this section) provided:

(1) *Written Guidelines.* The Board shall establish and periodically review written guidelines (including guidelines for determining whether securities present minimal credit risks as required in paragraph (c)(3) of this section) and procedures under which the delegate makes such determinations:

(2) *Oversight.* The Board shall take any measures reasonably necessary (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 or Event of Insolvency with respect to the issuer of the security or any Guarantee to which it is subject that requires notification of the Commission under paragraph (c)(6)(iii) of this section) to assure that the guidelines and procedures are being followed.

5. Section 270.2a41–1 is amended by revising the introductory text of paragraph (a) to read as follows:

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

(a) A standby commitment means a right to sell a specified underlying security or securities within a specified period of time and at an exercise price equal to the amortized cost of the underlying security or securities plus accrued interest, if any, at the time of exercise, that may be sold, transferred or assigned only with the underlying security or securities. A standby commitment entitles the holder to receive same day settlement, and will be considered to be from the party to whom the investment company will look for payment of the exercise price. A standby commitment may be assigned a fair value of zero, Provided, That:

* * * * *

6. Section 270.12d3–1 is amended by revising paragraph (d)(7)(v) to read as follows:

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

* * * * *

(d) * * *

(7) * * *

(v) Acquisition of Demand Features or Guarantees, as these terms are defined in § 270.2a–7(a)(8) and § 270.2a–7(a)(14) respectively, provided that, immediately after the acquisition of any Demand Feature or Guarantee, the company will not, with respect to 75 percent of the total value of its assets, have invested more than ten percent of the total value of its assets in securities underlying Demand Features or Guarantees from the same institution. For the purposes of this section, a Demand Feature or Guarantee will be considered to be from the party to whom the company will look for payment of the exercise price.

* * * * *

7. Section 270.17a–9 is revised to read as follows:

§ 270.17a–9 Purchase of certain securities from a money market fund by an affiliate, or an affiliate of an affiliate.

The purchase of a security that is no longer an Eligible Security (as defined in paragraph (a)(10) of § 270.2a–7) from an open-end investment company holding itself out as a ''money market'' fund shall be exempt from section 17(a) of the Act (15 U.S.C. 80a–17(a)), provided that:

(a) The purchase price is paid in cash; and

(b) The purchase price is equal to the greater of the amortized cost of the security or its market price (in each case, including accrued interest).

8. Section 270.31a–1 is amended by revising the last sentence of paragraph (b)(1) to read as follows:

§ 270.31a–1 Records to be maintained by registered investment companies, certain majority-owned subsidiaries thereof, and other persons having transactions with registered investment companies.

* * * * *

(b) * * *

(1) * * * In the case of a money market fund, also identify the provider of any Demand Feature or Guarantee (as defined in § 270.2a–7(a)(8) or § 270.2a–7(a)(14) respectively) and give a brief description of the nature of the Demand Feature or Guarantee (*e.g.*, unconditional demand feature, conditional demand feature, put, letter of credit, or bond insurance) and, in a subsidiary portfolio investment record, provide the complete legal name and accounting and other information (including sufficient information to calculate coupons, accruals, maturities, puts, and calls) necessary to identify, value, and account for each investment.

* * * * *

9. Section 270.34b–1 is amended by revising paragraph (b) (the Note remains unchanged), to read as follows:

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

* * * * *

(b)(1) Except as provided in paragraph (b)(2) of this section:

(i) In the case of sales literature regarding a money market fund:

(A) Any quotation of yield or similar quotation purporting to demonstrate the income earned or distributions made by the money market fund, shall be accompanied by a quotation of current yield specified by paragraph (d)(1) of § 230.482 of this chapter;

(B) Any quotation of tax equivalent yield or other similar quotation purporting to demonstrate the tax equivalent yield earned or distributions made by the money market fund shall be accompanied by a quotation of tax equivalent yield as specified in paragraph (d)(1) of § 230.482 of this chapter; and

(C) Any quotation of total return shall cover a period of no less than one year and shall be accompanied by a quotation of the fund's current yield described in paragraph (b)(1)(i) of this section which shall be given equal prominence.

(ii) In the case of sales literature regarding a company other than a money market fund:

(A) Any quotation of yield or similar quotation purporting to demonstrate the income earned or distributions made by the company shall be accompanied by a quotation of current yield specified by paragraph (e)(1) of § 230.482 of this chapter; and

(B) Any quotation of tax equivalent yield of other similar quotation purporting to demonstrate the tax equivalent yield earned or distributions made by the company shall be accompanied by a quotation of tax equivalent yield as specified in paragraph (e)(1) of § 230.482 of this chapter.

(2) The requirements specified in paragraphs (b) (1) and (2) of this section shall not apply to any quarterly, semi-annual, or annual report to shareholders under Section 30 of the Act (15 U.S.C. 80a-29), containing performance data for a period commencing no earlier than the first day of the period covered by the report; nor shall the requirements of paragraphs (e)(3)(ii) and (f) of § 230.482 of this chapter apply to any such periodic report containing any other performance data.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

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

10. The authority citation for part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78w(a), 78ll(d), 79e, 79f, 79g, 79j, 79l, 79m, 79n, 79q, 79t, 80a–8, 80a–-29, 80a–30 and 80a–37, unless otherwise noted.

* * * * *

11. The authority citation for Part 274 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a–8, 80a–24, and 80a–29, unless otherwise noted.

Form N–1A [Amended]

12. Part B, Item 22(a) of Form N–1A (referenced in §§ 239.15A and 274.11A) is amended by:

(a) Adding in paragraphs (i) and (ii) the phrase ''and income other than investment income'' after the phrase ''exclusive of capital changes'' in each paragraph.

(b) Adding at the end of Instruction 2 the following: ''Exclude income other than investment income.''

* * * * *

Note: Form N–1A does not and the amendments will not appear in the Code of Federal Regulations.

13. Guide 21 (Disclosure of Risk Factors) to Form N–1A (referenced in 17 CFR 239.15A and 274.11A) is amended by revising the word ''effect'' to read ''affect'' in the sentence of the last paragraph.

* * * * *

Note: Guide 21 to Form N–1A does not and the amendments will not appear in the Code of Federal Regulations.

14. Guide 35 (Money Market Fund Investments in Other Money Market Funds) to Form N–1A (referenced in 17 CFR 239.15A and 274.11A] is amended by revising the last sentence to read as follows:

* * * Paragraph (c)(4)(ii)(E) of rule 2a–7 describes the obligations of a fund that invests substantially all of its assets in another money market fund.

Note: Guide 35 to Form N–1A does not and the amendments will not appear in the Code of Federal Regulations.

Form N–3 [Amended]

15. Item 25(a) of Form N–3 (referenced in §§ 239.17a and 274.11b) is amended by:

(a) Adding in paragraphs (i) and (ii) the phrase ''and income other than investment income'' after the phrase ''exclusive of capital changes'' in each paragraph.

(b) Adding at the end of Instruction 3 the following: ''Exclude income other than investment income.''

* * * * *

Note: Form N–3 does not and the amendments will not appear in the Code of Federal Regulations.

16. Guide 38 to Form N–3 (Money Market Fund Investments in Other Money Market Funds) (referenced in 17 CFR 239.17a and 274.11b) is amended by revising the last sentence to read as follows:

* * * Paragraph (c)(4)(ii)(E) of rule 2a–7 describes the obligations of a fund that invests substantially all of its assets in another money market fund.

Note: Guide 38 to Form N–3 does not and the amendments will not appear in the Code of Federal Regulations.

Form N–4 [Amended]

17. Part B, Item 21(a) of Form N–4 (referenced in §§ 239.17b and 274.11c) is amended by:

(a) Adding in paragraphs (i) and (ii) the phrase ''and income other than investment income'' after the phrase ''exclusive of capital changes'' in each paragraph.

(b) Adding at the end of Instruction 3 the following: ''Exclude income other than investment income.''

* * * * *

Note: Form N–4 does not and the amendments will not appear in the Code of Federal Regulations.

By the Commission.

Dated: December 10, 1996.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96–31783 Filed 12–17–96; 8:45 am]

BILLING CODE 8010–01–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

21 CFR Parts 1301 and 1304

[DEA–143P]

RIN 1117–AA36

Establishment of Freight Forwarding Facilities for DEA Distributor Registrants

AGENCY: Drug Enforcement Administration (DEA), Justice.

ACTION: Proposed rule.

SUMMARY: In response to industry concerns, the Drug Enforcement Administration (DEA) proposes to amend its regulations to define the term freight forwarding facility. DEA further proposes to amend its regulations to exempt certain freight forwarder facilities from registration requirements. These amendments will establish regulatory guidelines under which distributors registered with DEA may utilize freight forwarding facilities when shipping controlled substances to another DEA registrant.

DATES: February 18, 1996.

ADDRESSES: Comments and objections should be submitted in quintuplicate to the Deputy Assistant Administrator, Office of Diversion Control, Drug Enforcement Administration, Washington, DC 20537, Attention: DEA Federal Register Representative/CCR.

FOR FURTHER INFORMATION CONTACT: Mr. G. Thomas Gitchel, Chief, Liaison and Policy Section, Office of Diversion Control, Drug Enforcement Administration, Washington, DC 20537, Telephone (202) 307–7297.

SUPPLEMENTARY INFORMATION:

I. Background

For many years, distributors registered with the DEA have utilized the services of common carriers to transport controlled substances to other registrants. These common carriers, who are not DEA registrants and therefore are not subject to the security and record keeping regulations promulgated pursuant to the Controlled Substances Act (CSA), often transfer the controlled substances from one conveyance to another at certain points during the shipment. In-transit losses due to theft of controlled substances have frequently occurred at these transfer points.

In discussions with DEA, distributors have expressed their interest in utilizing ''freight forwarding facilities,'' enabling them to employ proprietary or contracted shipping and better prevent in-transit losses. These controlled substance distributors represent that permitting distributors to utilize freight forwarding facilities will not only minimize in-transit losses, it will also facilitate more timely delivery of controlled substances and help lower health care costs.

To accomplish these goals, DEA proposes to permit distributors to extend their registrations to freight forwarding facilities operated by the distributor. In so doing, DEA is providing distributors an alternative means of delivery and allowing them to exercise direct control and responsibility for the controlled substances. By so extending the registration, the distributor will be required to comply with certain security and record keeping requirements proposed below.

Pursuant to these regulations, DEA proposes to allow distributors to use certain designated freight forwarding facilities as an extension of their registration. However, DEA has determined that due to security concerns, returns of controlled substances cannot be routed through the freight forwarding facilities because the registrant operating the facility will have no control over when drugs will be returned to the facility. Distributors who use freight forwarding facilities will not be required to obtain a separate registration for such facilities, but will be required to comply with record keeping and security requirements detailed below.

Distributors will be required to notify DEA in advance of their intent to utilize a freight forwarding facility. The distributor understands that if DEA approves the distributor's request, DEA will have the authority to conduct administrative inspections of the freight forwarding facility pursuant to 21 U.S.C. 822 and 880.

II. Notification of Use of a Freight Forwarding Facility

Although no separate DEA registration will be required for utilization of freight forwarding facilities for DEA distributor registrants, it will be necessary to notify DEA of their existence. DEA distributor registrants who intend to operate a freight forwarding facility must first notify both the DEA office in the area in which the distributor is located and the office in which the freight forwarding facility will be located. This facility must be for exclusive use of the named DEA distributor registrant and cannot be shared for use by another DEA registrant. Notification must be accomplished by registered letter, return receipt requested. If DEA does not communicate written disapproval within 21 days after confirmed receipt, the facility will be considered approved. Reasons for disapproval of a freight forwarding facility might include a registrant's failure to comply with DEA regulations or a history of losses.

Notification should consist of the distributor's DEA registration number, registered address and the address of the freight forwarding facility. A description of the operation of the freight forwarding facility should be included, listing such information as the hours of operation and the name, home address and date of birth of the designated responsible person. Information should be provided indicating what measures have been taken to limit accessibility to controlled substances at the facility. Notification should also include a description of the physical security in place at the facility. The physical security description should include a summary of the controlled substance temporary storage area including dimensions, specifications and alarm devices and identify the central station provider or delineation of the registrant's control station as specified in 21 CFR 1301.72(b)(4)(v).

A description of the recordkeeping procedures should also be included in the notification by providing an outline of recordkeeping procedures or copies of sample records.

III. Security of Freight Forwarding Facilities

The DEA distributor registrant utilizing a freight forwarding facility is