

**National Federation of Municipal Analysts**  
***Recommended Best Practices in Disclosure***  
***for Variable Rate and Short-Term Securities***

The National Federation of Municipal Analysts (NFMA) is an organization of nearly 1,000 members, primarily research analysts, who evaluate credit and other risks of municipal securities. These individuals represent, among others, mutual funds, insurance companies, broker/dealers, bond insurers, and rating agencies.

One of the main initiatives of the NFMA is to promote timely and complete disclosure of the financial and operating information needed to assess the credit quality and risk of a municipal debt issue. The NFMA's efforts have ranged from global disclosure-related issues to more detailed, sector-specific work. For further information on the NFMA's continuing work in the area of disclosure, please see the "Disclosure Guidelines" and "Position Statements" on the NFMA's web site at [www.nfma.org](http://www.nfma.org).

In order to develop our Recommended Best Practices in Disclosure, diverse groups of NFMA analysts worked with non-analyst professionals in each sector to develop "best practices" guidelines for certain market sectors. These Recommended Best Practices are descriptions of the specific information needed to help analysts do their jobs. The NFMA believes that the best practice in disclosure will always be the one that provides a steady flow of timely information from borrowers to the entire market. Initial drafts of our Recommended Best Practices in Disclosure were widely circulated, and an industry comment period was used to seek input from interested parties. Subsequent to the comment period, the papers were revised. For certain sectors, Comment and Response papers were drafted; these papers are available on the NFMA web site, providing additional information on the comments received.

Following is the most recent version of the Recommended Best Practices in Disclosure for this sector. This document is not intended to supplant the amendments to Rule 15c2-12 or Rule 2a-7, but to be used in conjunction with the guidance provided in these rules and amendments. It is important to note that the NFMA's disclosure efforts are a continuing process. These guidelines are not static documents, and will be revisited and changed as market conditions warrant. We encourage interested parties to submit comments at any time to [lgoodnfma@adelphia.net](mailto:lgoodnfma@adelphia.net) so that they can be considered in the development of future versions of these Recommended Best Practices in Disclosure.

*The NFMA Recommended Best Practices in Disclosure are not intended to be a "one size fits all" recommendation, and all the information requested may not apply to every transaction in the sector. We encourage the providers of information to indicate when a specific item requested in the Recommended Best Practices is not applicable to a specific transaction.*

## Introduction

This document focuses on disclosure needs associated with variable-rate and short-term securities. These Disclosure recommendations for variable rate and short-term securities are driven by the regulations applicable to money market investors, which are the largest purchasers of short-term securities. These investors are responsible for compliance with the March 1996 Amendments and December 1997 Technical Amendments to the Investment Company Act of 1940, Section 2a-7 ("Rule 2a-7") which govern eligible investments for money market funds.<sup>1</sup> Although some obligors are aware of the requirements of Rule 2a-7 and have adopted the disclosure practices required for their securities to be Rule 2a-7 eligible, a material number of new and remarketed issues are still offered that require structural modifications to be considered eligible for money market investment. This typically reflects an incomplete or incorrect understanding of the intricacies of Rule 2a-7 on the part of the obligor and its bankers and counsel.

The thrust of Rule 2a-7 is to allow a mutual fund to utilize the amortized cost method of valuation. To do this, the portfolio must conform to strict requirements with respect to security structure, portfolio diversification, effective maturity, and credit quality. As a result, many of the disclosure best practices that follow address structural characteristics of the security and not credit per se. While obligors are not required under SEC Rule 15c2-12 to provide continuing disclosure on short-term and variable-rate securities, money market investors are required to have regularly updated information to make regular determinations of creditworthiness of the obligor, the credit enhancer or liquidity provider, as applicable.

The following Recommended Best Practices in Disclosure for Variable Rate Demand Notes (VRDNs) and short-term Securities apply to a broad range of issuers and debt issues of varying size and complexity. For VRDNs, particularly credit enhanced deals, our analysis is focused on the aspects that are required to allow for a full substitution of the ultimate borrower's credit by a third-party for purposes of Rule 2a-7. The analysis is more of a structural nature encompassing aspects of Rule 2a-7, Subchapter M, tax exemption, automatic termination events, and less on traditional credit analysis of the borrower or credit enhancer. We recognize that a traditional credit analysis of the true counter party is also required to make an informed investment decision, but note that would be handled by separate analysis and discussion which would be more appropriate for sector specific Recommended Best Practices in Disclosure papers.

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<sup>1</sup> 17 CFR 270.2a-7, as amended by Release 21837 and 22921. Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 21837 (March 21, 1996) [61 FR 13956 (March 28, 1996)] ("Release 21837"). The current text of Rule 2a-7 is attached as Exhibit 1 hereto. Alternatively, see internet address <http://www.law.uc.edu/CCL/sldtoc.html> for a complete copy of the Rule.

This document does not address the specifics of secondary market synthetic securities, prerefunded bonds, and long-term bonds whose final maturity has come into money market eligibility.

- Secondary market synthetic securities, which are usually structured as VRDNs, have structural and disclosure issues similar to primary market securities. The structural issues will be discussed in this document. Additional analysis typically conducted on synthetic securities is of a tax and legal nature and is not within the scope of this document.
- Prerefunded or escrowed to maturity securities are specifically addressed by Rule 2a-7; special provisions include the certification of the escrow by an independent CPA or that the refunded security has been rated by a Nationally Recognized Securities Rating Organization (NRSRO).
- For long-term bonds that have become money market eligible, we refer obligors to the sector specific NFMA Recommended Best Practices.

We would also like to note that assignment of a short-term rating by the NRSROs does not mean that a security has met all of the SEC requirements to be eligible to be acquired by a money market fund. While rating agency analysts are familiar with Rule 2a-7, they do not include compliance with it in their rating assessments. This best practices paper is not a recapitulation of SEC requirements, however, and does go beyond the rating agencies and the SEC where appropriate.

This document is not comprehensive as to all items that should be included in an offering document, but rather has focused on some of the items that are often not uniformly disclosed for variable-rate and short-term securities and that are required or highly desirable for purchase of the security by a money market fund. The fact that money market funds constitute the primary market for such securities should provide ample incentive for obligors and their advisors to understand and meet their requirements. Moreover, those non-money market accounts that also purchase variable-rate and short-term securities generally are managed by fiduciaries that will require most if not all of the structuring and disclosure required by money market funds.

**Obligors are encouraged to consider these suggested practices as a floor and not a ceiling. Improved disclosure is in the interest of all market participants, as it should expand the investor base and improve liquidity.**

## Organization of the Document

This document is organized to address the disclosure requirements of the different types of short-term debt. Section A provides an overview of pertinent requirements of Rule 2a-7. Section B discusses variable rate securities, which include variable rate demand notes, bonds in term mode ("put bonds") and commercial paper. Section C addresses short-term fixed-rate securities. The specific sections are:

### A. Overview of Rule 2a-7

- 1) Quality Requirements
- 2) Diversification Requirements
- 3) Maturity Requirements
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### B. Variable Rate Securities

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- 3) Securities with Conditional Demand Features
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- 1) Bond Anticipation Notes (BANs)
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1. Description of Available Assets
2. Cash flows
3. Rule 2a-7

## A. Overview of Rule 2a-7

All mutual funds that hold themselves out as “money market funds” are governed by Rule 2a-7 under the Investment Company Act of 1940 (the “Investment Company Act”). Rule 2a-7 establishes substantive limits on securities that are “eligible securities” for a money market fund, including strict limits on (1) the quality of instruments in which a money market fund may invest, (2) the diversification of instruments in the fund’s portfolio, and (3) the weighted average maturity of such instruments. Rule 2a-7 also imposes procedural requirements on the fund’s board of directors and investment adviser for establishing compliance with these substantive restrictions; and allows the fund’s board of directors to delegate the administration of and compliance with these restrictions to the fund’s investment advisor pursuant to written procedures.

### 1) Quality Requirements

With limited exceptions, money market funds (including tax-exempt money market funds) may not purchase or hold a security unless it is rated in one of the two highest short term rating categories by a specified number of nationally recognized statistical rating organizations (“NRSROs”), or, if not rated, is comparable in quality to such rated instruments.

In addition, all securities purchased by a money market fund must meet a “minimal credit risk” requirement. The fund’s advisor must make the independent minimal credit risk determination prior to purchase, and such determination must be documented in writing.<sup>2</sup>

**It is important to note, that the fact that a rating agency has given a qualifying short or long-term rating to a security is not equivalent to a determination of minimal credit risk by the fund’s advisor and therefore, does not mean that the security is automatically suitable for purchase by a money market fund. This central requirement is all too often unknown to, or ignored by, the obligor and those who advise and assist it in structuring a VRDN or other short-term security.** Further, if a security ceases to present minimal credit risk, it becomes an ineligible security and may have to be sold as promptly as practicable.

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<sup>2</sup> The SEC’s Division of Investment Management has stated that examples of elements of such an independent credit analysis include: a cash flow analysis; an assessment of the issuer’s ability to react to future events, including a review of the issuer’s competitive position, cost structure and capital intensiveness; an assessment of the issuer’s liquidity, including bank lines of credit and alternative sources of liquidity to support its commercial paper; and a ‘worst case scenario’ evaluation of the issuer’s ability to repay its short-term debt from cash sources or assets liquidations in the event that the issuer’s backup credit facilities are unavailable; Letter from staff of SEC Division of Investment Management to Registrants (pub. avail. May 8, 1990); macro-economic factors which affect the issuer’s or guarantor’s current and future credit quality; the strength of the issuer’s or guarantor’s industry within the economy and relative to economic trends; the issuer’s or guarantor’s market position within its industry; cash flow adequacy; the level and nature of earnings; financial leverage; asset protection; the quality of the issuer’s or guarantor’s accounting practices and management; and the likelihood and nature of event risks; Letter from staff of SEC Division of Investment Management to Investment Company Institute (pub. avail. Dec. 6, 1989); and any additional factors it believes to be material in assessing the credit risks posed by a particular investment; Revisions to Rules Regulating Money Market Funds, July 17, 1990.

## **2) Diversification Requirements**

Rule 2a-7 subjects money market funds to strict diversification requirements. Consequently, the identity of the obligor on a security and of any guarantor/credit enhancer or liquidity provider must be known at all times. Rule 2a-7 requires that the fund receive notice prior to any change in the identity of an obligor, guarantor/credit enhancer or liquidity provider. In addition, because the requirements for Rule 2a-7 diversification are tighter if there is a control relationship between the obligor and a provider of credit enhancement or liquidity for a security, the existence of any such control relationship must be known at all times.

## **3) Maturity Requirements**

Rule 2a-7 limits the weighted average maturity of the investments owned by a money market fund to 90 days, with no maturity to exceed 397 days. A security with a nominal maturity that exceeds the maturity restrictions of Rule 2a-7 (as is the case with the typical VRDN) may nonetheless qualify if the money market fund has the right to tender or put the security within the time period (30 days) specified under Rule 2a-7. Such a tender or put right may be unconditional, or, subject to certain limitations, conditional. Because the availability of the tender or put right is crucial to compliance with the maturity restrictions, the creditworthiness of the party obligated to fund the tender or put must be high, and the likelihood of occurrence of any “terminations” on such party’s funding obligation must be remote. Specifically, the following requirements of Rule 2a-7 must be satisfied for a security to comply with a money market fund’s maturity restrictions based on a conditional tender or put right (a “Conditional Demand Feature”):

### **Rule 2a-7(c)(3)(iv) - Portfolio Quality: Securities Subject to Conditional Demand Features**

“A security that is subject to a Conditional Demand Feature (“Underlying Security”) may be determined to [satisfy the maturity and credit requirements of Rule 2a-7] only if:

- (A) The Conditional Demand Feature [meets the requirements of Rule 2a-7];
- (B) At the time of the [a]cquisition 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,..."

#### **4) Procedural Requirements**

Compliance with the requirements of Rule 2a-7 must be tested at the time of purchase of the security, and the analyst for a money market fund must be in a position to monitor the continuing eligibility of all securities held by the fund (e.g., the identity of all obligors, credit enhancers and liquidity providers, rating status, minimal credit risk status, minimal risk status regarding loss of tender or put right). Changes to any fundamental characteristics of the security must be disclosed to investors and potential investors.

Credit-enhanced deals and deals with liquidity facilities present difficult procedural issues with respect to substitution of the credit enhancer or liquidity provider, as applicable. Even if the rating of the security will be maintained, the requirements regarding minimal credit risk determination and diversification necessitate notice to the money market fund in sufficient time for the fund to make the required determinations in advance of the substitution. Securities generally are held through the DTC book-entry system, and the translation and timing risks inherent in the communication of notices from the obligor or issuer to DTC to the DTC participant to the beneficial owner/money market fund are such that most money market funds insist on a mandatory tender (with a right to retain) for any security upon a credit enhancement or liquidity facility substitution (or change of any other feature that must be evaluated for Rule 2a-7 compliance).

As noted above, where compliance with the Rule 2a-7 maturity requirements depends on the existence of a liquidity facility supporting a tender right, the conditions giving rise to a termination or suspension of the tender right must be both remote and monitorable, and accordingly the analyst for the money market fund must be provided with sufficient ongoing information to permit the necessary monitoring. Alternatively, the security must be structured in a manner that ensures that the money market fund will receive notice of the potential termination event with sufficient time to effect a tender before the liquidity facility terminates.

Rule 2a-7 can be found in Appendix 3 and can be referred to for more detail. In addition, issuers and investment bankers who are bringing to market short-term debt that is intended to be offered to money market funds should consider consulting with or retaining bond counsel with an expertise in the Investment Company Act and regulations applicable to money market funds, including Rule 2a-7. This is particularly true for VRDNs, which often raise a variety of structuring and compliance issues. Alternatively, such issuers and investment bankers should consider speaking directly with the analysts who manage money market fund assets, most of whom are more than happy to provide their specific requirements for determining that a security is eligible for purchase.

## **B. Variable Rate Securities**

In order to facilitate a money market fund analyst's determination that a variable rate security is eligible for purchase and continues to be an eligible money market fund investment, the NFMA has compiled the following Recommended Best Practices in Disclosure. (Even if the target market for the offering does not include money market funds, most of the requirements addressed by these recommendations will need to be met to permit fiduciaries to purchase such securities on behalf of their clients.) The first subsection contains recommendations applicable to all variable rate securities, and is followed by additional subsections containing recommendations applicable to particular types of variable rate securities.

### **1) General Items – Official Statement Disclosure**

#### **Concise Outline**

- Include near the front of the official statement a concise outline of the following terms of the security, if applicable:
  - mandatory tenders and/or notice provisions, and/or provisions of bond counsel opinions associated with:
    - substitution, termination (scheduled or early) or extension of credit facilities;
    - substitution, termination (scheduled or early) or extension of liquidity facilities
    - mode changes; and
    - creation of or a change in a control relationship between a credit facility or liquidity facility provider and obligor
  - conditions that may cause termination of a credit facility or liquidity facility prior to a mandatory tender.

#### **Underlying Obligor and Project**

- Identify and provide background information on the obligor. If the security does not have credit enhancement, the recommended disclosure should follow the NFMA's Recommended Best Practices for that sector. (Please see Section B.4. for recommended disclosure for obligors providing self-liquidity.) Identify the purpose of the borrowing and the use of proceeds. If any part of the project has a private or commercial use, the project's cost and source of funding should be identified. It is recommended that the obligor disclose reasonable detail about the project being financed (e.g., capital projects, equipment or renovations) and the location and anticipated completion date of each discrete project being financed.



- If the security is a pooled transaction, provide disclosure on the underlying obligors including what percentage of the pool each obligor represents and whether each obligor's percentage will remain static over the life of the security. For diversification purposes, analysts must be able identify each obligor representing 10% of a pool.
  - If the pool is not static but there will never be any 10% obligors, there should be an affirmative statement to that effect.
  - If the pool is not static and there may be 10% obligors, there should be periodic continuing disclosure on the composition of the pool.
- If there is credit enhancement or a liquidity provider on the security, provide an affirmative statement regarding the control relationship between the institution providing the enhancement or liquidity and the obligor, and pledge continuous disclosure if there ever is a change in the relationship.
- Issuers should be aware that some investors perform a credit review and ongoing surveillance of the underlying obligor even if the security includes credit enhancement. Those organizations may request initial and continuing disclosure of financial and operating information for the obligor and the project.

### **Interest Modes and Conversion**

- Variable rate securities often have different possible interest rate modes such as daily, weekly, monthly, dutch-auction, commercial paper and term. The maximum or ceiling interest rate should be provided, as well as all allowed interest rate modes and the initial mode that will be utilized. Disclosure should be provided on when and how the interest rate is established and updated in each of the various modes. Disclosure should clearly indicate that the remarketing agent is obligated to establish a rate for the security that would allow it to be sold for its amortized cost value plus accrued interest. The section on interest rates should also disclose the method for determining a default rate if for some reason a new rate is not established.
- Identify the procedure for interest rate conversions. Our recommended method is to provide a mandatory tender when there is a conversion between interest rate modes.
- Specific details should be provided if the security can be converted to a fixed rate interest mode, or any other non-money-market eligible maturity, and there should always be a provision for a mandatory tender in advance of any such conversion.
- Include the interest accrual and payment schedule. Distinguish between the interest accrual and interest payment dates.

### **Demand Feature or Optional Tender**

- Disclosure should be provided about the optional tender or demand feature provided on the security, including the provider of the liquidity and its long and short-term ratings.
- Disclosure should be provided on the exercise price, which must be the amortized cost value plus accrued interest.
- Disclosure should specify the method of exercising a tender and its required timing, including whether the period is in business or calendar days. The required notice interval on an optional put bond may not exceed 30 calendar days. Other demand features allow exercise at specified intervals or dates; those specified intervals must be no longer than 397 calendar days and may require no more than 30 calendar days advance notice of exercise of the demand feature.
- Prominently identify any events that cause a bondholder to lose the ability to tender.
- Provide disclosure on the sources of funds, including the priority, for funding the demand feature (e.g., remarketing proceeds, draws on credit or liquidity facilities, or obligor's funds).

### **Notification of Changes in Credit Enhancer or Liquidity Provider**

- Holders of VRDN's must receive prompt notification in the event that there is a substitution of the provider of credit enhancement or liquidity for a tender or put feature. The disclosure must identify how beneficial owners will be notified of any such substitutions. Our recommended method of notification is to provide a mandatory tender prior to the substitution, with a right to retain by the beneficial owner's exercise of an affirmative retention right. If a mandatory tender is not required prior to such a substitution, the disclosure must specify the timeframe within and means by which prior notice of such substitution will be provided to beneficial owners. As part of the notification and/or mandatory tender, beneficial owners, as well as the remarketing agent, should receive relevant information on the new credit or liquidity facility prior to it becoming effective. It is recommended that this be done via a supplementary offering memorandum (which generally will be prepared in any event for remarketing purposes) provided to the existing beneficial owners, which also should be sent to NRMSIRs.
- For VRDN's that include a commercial paper mode, the documents must specify that all notes are required to mature prior to the expiration date of the third party facility, as a mandatory tender upon expiration would cause a shortening of the maturity of the instrument, at best, and loss of the credit support at worst. For

debt that is issued only as commercial paper, the documents should state that substitution may only be accomplished when no commercial paper is outstanding. However, notification of this change should be provided to the NRMSIRs prior to the change, as well as to the remarketing agent, for dissemination to new purchasers of the commercial paper.

- The documents should require an annual affirmative statement to the trustee regarding the control relationship between the institution providing the enhancement or liquidity and the obligor, and prompt notification to beneficial owners if there ever is a change in the relationship. (It is increasingly common for banks to partially own projects as part of their Community Reinvestment Act lending.)

### **Tax Issues**

- Bond Opinion: The opinion should address whether or not the security is legal, valid, and binding on the obligor, as well as what, if any, tax related issues are addressed (i.e. federally tax exempt, subject to the alternative minimum tax, state income tax exempt, and/or bank qualified). The information provided should be as complete as possible so that a user may gain a full appreciation for the tax issues involved with owning the security.
- Disclosure should be provided regarding any special provisions for a determination of taxability for the security. If there is a mandatory redemption upon taxability, the specific timing of the redemption should be disclosed as well as how a premium, if any, will be funded. We recommend that mandatory redemptions be present and accomplished within a short, but finite time period after a determination.
- A Litigation section should address whether there is any actual, pending or threatened litigation that could affect the taxability of the issue or the issuer, or the creditworthiness of the obligor.

### **Miscellaneous**

- Ratings: Disclose if the security will be rated by a rating agency. If the security will be rated, identify the rating agency, whether short-term and/or long-term ratings will be assigned, and the expected rating to be assigned.
- Contact information: Provide the title, phone number, e-mail address, and regular mailing address for the Issuer, Obligor, Credit Enhancer, Liquidity Provider, Trustee, Bond Counsel, and Remarketing Agent. It is recommended that the credit enhancer/liquidity provider and the Trustee be different entities due to possible conflicts of interest in a default situation. If, however, the Trustee is also

the provider of credit enhancement and/or liquidity, there should be disclosure about possible conflicts of interest in a default situation.

- The offering document should provide a summary of relevant documents, such as indenture, loan agreement, credit enhancement agreements and/or liquidity agreements. Additionally, provide information as to how complete copies of these documents can be obtained. Recommendation is to have them available from a single source at no charge to the requestor. Electronic postings are encouraged.
- Disclose all mandatory tender or extraordinary redemptions for items such as expiration of credit facility without an extension or substitution, conversion between variable interest rate modes, conversion to a fixed mode, condemnation of the project, insolvency of the credit provider, imminent termination of a liquidity facility that is not an automatic termination event, etc.

### **Continuing Disclosure**

- An official statement for a VRDN generally is used in connection with a continuous primary offering of securities (*i.e.*, each remarketing constitutes a primary offering<sup>3</sup>); accordingly, regardless of any available exemption from the continuing disclosure requirements of Rule 15c2-12, all material terms of the security must be updated (through a revised or supplemented official statement) in connection with each remarketing. For example, the identity of and contact information for the current provider, current expiration date or other material terms of the current credit enhancement facility or liquidity facility must be reflected in the official statement provided at the time of a remarketing.
- The official statement should indicate the scope of any continuing disclosure undertaking. Even if the security is exempt from the specific continuing disclosure requirements imposed under Rule 15c2-12, the marketing of the security to money market funds and other fiduciaries generally will require at least the limited continuing disclosure undertakings described below.
- The increasing use of VRDNs or commercial paper with third-party or self-liquidity by obligors throughout the market has resulted in a need for continuing disclosure to allow beneficial owners to regularly make a determination of minimal credit risk. The amount of continuing information about the obligor in a structure that includes third-party credit enhancement and a third-party liquidity facility may vary with the circumstances. However, the following two

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<sup>3</sup> See *Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Transactions with Sophisticated Municipal Market Professionals*; SEC Release No. 34-45364, 2002 LEXIS 276 (January 30, 2002) at n. 78.

recommendations relating to continuing disclosure apply regardless of the existence or non-existence of credit enhancement or a third party liquidity facility.

- Include, and disclose the existence of, a covenant to provide to bondholders basic project information as it arises:
  - the occurrence of any event that might give rise to a risk of taxability,
    - the existence of any threatened or pending regulatory or legal proceeding, including any audit (whether “random” or “targeted”) of the tax-exemption of the security or other action that might result in a determination of taxability,
    - the completion of the project and/or the expenditure of all funds,
    - the existence of any circumstances which would cause the project not to be completed or to be abandoned,
    - the existence of any circumstance that would cause the project to be converted to a different use or ownership than that which gave rise to the tax exemption.
- Include, and disclose the existence of, a covenant to:
  - provide to bondholders basic information about the existence of any defaults under any of the bond documents as they arise (including defaults that have been waived),
  - respond to questions from bondholders and prospective bondholders about the circumstances giving rise to the default.
- All continuing disclosure should be provided directly to the remarketing agents for disbursement to the beneficial owners, and simultaneously made available to the NRMSIRs for dissemination to the market.
- Any supplementary offering memorandum or “wrap” to an existing offering memorandum used to remarket tendered securities (including such supplementary disclosure with respect to credit enhancement or liquidity facility substitutions or amendments to structures) should also be sent by the trustee or remarketing agent to beneficial owners that are not required to tender (or have a right to retain), as well as submitted as a material event to the NRMSIRs.
- Through the appropriate documents, trustees should be instructed to provide requested information to beneficial owners of the bonds on items such as credit enhancements, liquidity facilities, extensions of expiration dates for credit enhancements or liquidity facilities, bond redemptions or tenders, etc.

## **2) Securities Enhanced by a Letter of Credit (LOC)**

### ***a) Official Statement Disclosure***

In issues that are enhanced with a letter of credit, the third-party provider's credit stands in for that of the underlying obligor's credit, provided that appropriate structural requirements are met to allow the investor to continue to be paid by the third-party LOC provider even while the obligor is in bankruptcy proceedings. The letter of credit should be an irrevocable direct-pay obligation of the provider. It is critical that the offering documents disclose any conditions or terms of the LOC that would affect the investor's security.

Primary disclosure for commercial paper (CP) programs enhanced by an LOC should be as complete as that provided for a VRDN. Full disclosure of the terms of the LOC as well as the actions required for a substitution of the credit enhancer, including notification to the remarketing agent, is mandatory.

### **LOC Terms and Coverage**

- Initial expiration date of LOC and information about renewal or extension, including whether the LOC has an automatic renewal provision ("evergreen").
- The type of payments for which the LOC is to be utilized – regularly scheduled principal and interest payments, purchase price for optional tender/demand feature, mandatory tenders, optional redemptions, mandatory redemptions, accelerations, etc.
- Disclosure of the amount of principal coverage under the LOC.
- Disclosure of the number of days and maximum interest rate coverage under the LOC.
- Disclosure of how the LOC is reinstated for both principal and interest. After a draw to pay interest, LOCs typically either provide immediate reinstatement or automatic reinstatement after a specified number of days unless there is a notice of nonreinstatement to the trustee<sup>4</sup>. The number of days prior to reinstatement should be clearly specified, including whether they are calendar or business days. The remedy period, often not disclosed, is also typically identified in the indenture and should be summarized in the offering documents.

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<sup>4</sup> The trustee must then take some action such as an acceleration or mandatory tender. In order to confirm that there is sufficient interest coverage under the LOC, analysts need to know the length of any remedy period, beginning when the trustee receives notice that a bank will not reinstate the interest portion of the LOC and ending on the date on which the bondholders will receive payment of principal and interest for their bonds.



- While there has been a trend away from providing bankruptcy (“preference”) opinions, it is recommended that these opinions be provided, especially on non-rated securities.
- If there are multiple LOC providers, each provider’s degree of responsibility and participation should be clearly stated to allow money market funds to determine whether the third party support is fractional (joint) or layered (joint and several). The specific percentage covered by each provider should be clearly disclosed. In addition, there should be provisions to notify beneficial owners of any future changes in the percentages.

### **LOC Substitution**

- Identify whether the indenture allows for the provision of a substitute credit facility. Include details of the type of substitute credit facilities (LOC, insurance policy, GIC, confirming guarantee, or liquidity facility) that can be provided.
- Identify the requirements that must be satisfied for an alternative credit facility to be provided. Standard requirements are the delivery of a bond counsel opinion, confirmation of the rating (and whether the rating maintenance applies to long-term or short-term ratings), a preference opinion, an enforceability opinion, and notifications.
- Disclose the procedure and timing for providing a substitute credit facility and whether (as we recommend) a mandatory tender (with a right to retain) will occur prior to such substitution.
- Clearly identify in the credit enhancement section of the offering document whether there are multiple definitions of substitute facilities and separate procedures (e.g. ratings lowered, ratings maintained and improved, or confirmation and wraps of existing facilities) for the different definitions. Our recommended best practice is to have one definition of a substitute credit facility, but multiple definitions can be accommodated, provided that all definitions lead to notification. Additionally, there must be a mandatory tender in advance of any credit substitution that does not require maintenance of the current long-term or equivalent ratings.

### ***b) Continuing Disclosure***

- With an evergreen LOC, trustees should be instructed to provide an affirmative statement annually to the remarketing agent that the trustee has not received a notice of nonrenewal from the LOC Provider. In addition, the credit enhancement documents should provide for an annual statement from the issuing bank of an

evergreen LOC, acknowledging that it has not sent a notice of non-renewal to the trustee. These statements also should be provided to the NRMSIRs.

### **3) Securities with Conditional Demand Features**

#### ***a) General Information - Official Statement Disclosure***

A conditional demand feature can be in the form of a standby bond purchase agreement, line of credit, revolving credit agreement or credit facility that provides liquidity for the issue in the event of a failed remarketing but which the provider may immediately terminate upon the occurrence of certain credit events.

#### **Liquidity Termination Events**

Liquidity or standby purchase agreements typically provide that upon the occurrence of certain events, the liquidity provider can terminate its obligation to purchase the bonds upon exercise of a demand feature. The disclosure should be very specific as to which events result in an immediate termination or suspension without any notice versus those events which are not immediate, but do allow the liquidity provider to terminate their obligation after first funding a mandatory tender to purchase all bonds from beneficial owners.

Other than a determination of taxability of interest payment, all other conditions permitting termination of a third-party liquidity provider's obligation to honor a demand should directly relate to the creditworthiness and/or reliability of the credit party responsible for regularly scheduled principal and interest payments. Our recommendation is to limit these conditions only to:

- Default in principal or interest payment by the principal credit source;
- Insolvency of the principal credit source;
- All NRSROs downgrade the principal credit source below investment grade.

#### **Liquidity Coverage**

The basic features of the liquidity provision should be provided. The following minimum disclosure is recommended:

- The initial expiration date of the liquidity facility and information about renewal or extension, including whether the liquidity facility has an evergreen provision.
- The type of payments for which the liquidity facility is to be utilized: purchase price for optional tender/demand feature, mandatory tenders, etc.

- The sources of funds, including the priority, for funding the demand feature and specifically identify whether or not the borrower is responsible to fund the purchase price after an automatic termination event.
- Amount of principal coverage under the liquidity facility.
- Number of days and maximum interest rate coverage under the liquidity facility.
- Disclosure of how the liquidity facility is reinstated to its full amount after the remarketing of the bank bonds.

### **Liquidity Substitution**

- Identify whether a substitute liquidity facility can be provided under the terms of the transaction documents. Include details of the type of substitute liquidity facilities allowed, as well as the requirements [e.g., bond counsel opinion, rating maintenance confirmation (specify if the maintenance is based on long-term or short-term ratings), notifications, etc.] that must be satisfied for an alternative liquidity facility to be provided.
- Disclose the procedure and timing for providing a substitute liquidity facility and whether (as we recommend) a mandatory tender (with a right to retain) will occur prior to such substitution.

### ***b) Insured Securities with Liquidity– Official Statement Disclosure***

These securities, (also called “insured floaters”), incorporate an insurer that guarantees the regularly scheduled payment of principal and interest, and a liquidity provider that provides a conditional demand feature. In these structures, the liquidity provider relies on the insurer’s credit, and liquidity termination events should only be triggered by credit impairment of the insurer or the insurance policy, which is irrevocable and unconditional. Please see the previous section for a discussion of liquidity automatic termination events, liquidity coverage and liquidity substitution.

### **Insurance Coverage**

- Clearly disclose the type of payments that the bond insurance policy guarantees. Typically these will be regularly scheduled principal and interest payments, sinking fund payments and preference amounts. Exclusions under the policy should also be disclosed. Usual exclusions would be accelerations, optional redemptions, and bond premiums.

### **Insurance Substitution**

- Include the procedure and timing for providing a substitute bond insurance policy.
- Identify the requirements (e.g., bond counsel opinion, long term rating maintenance confirmation, approval of liquidity provider, etc.) that must be satisfied for an alternative bond insurance policy to be provided.

If a VRDN is supported by a liquidity facility with conditional demand features, and the demand feature terminates upon any change, amendment, modification, cancellation, or substitution of the bond insurer without the written consent of the liquidity facility provider, the relevant document(s) should include provisions that prohibit these actions without the written consent of the liquidity facility provider. The provision that prohibits any change, amendment, modification, cancellation, or substitution of the bond insurer without the written consent of the liquidity facility provider should also be summarized in the official statement.

### ***c) Unenhanced Securities with Third-Party Liquidity – Official Statement Disclosure***

These securities rely on the obligor for timely repayment of principal and interest while a third party provides a conditional demand feature. In these structures, the liquidity provider relies on the obligor's credit, and liquidity termination events should only be triggered by credit impairment of the obligor. Please see section B.3.a. for a discussion of liquidity automatic termination events, liquidity coverage and liquidity substitution.

### **Obligor Disclosure**

- Rely on other NFMA recommended sector best practices for initial and secondary market disclosure. Continuing disclosure should be provided to allow the investor to make regular determinations of creditworthiness.
- Provide disclosure on the sources of funds, including the priority, for funding the demand feature (e.g., remarketing proceeds, draws on credit or liquidity facilities, obligor's funds).
- Clearly indicate whether the obligor is responsible for covering tenders in the event that the liquidity provider fails to pay, either due to liquidity provider default or due to an event of default under the liquidity agreement (ie, an automatic termination event).

### ***d) Continuing Disclosure***

- Rely on the sector-specific NFMA Recommended Best Practices as appropriate.

- With an evergreen liquidity facility, trustees should be required to provide an affirmative statement annually to the remarketing agent that they have not received a notice of nonrenewal from the liquidity provider. In addition, the liquidity facility documents should provide for an annual statement from the issuing bank of an evergreen liquidity facility, acknowledging that it has not sent a notice of non-renewal to the trustee. This statement should also be provided to the NRMSIRs.

#### **4) Unenhanced Securities with Internal or Self-Liquidity**

While many obligors choose to use liquidity or standby purchase agreements to fund the demand feature, some choose to use their own liquid resources for this purpose. The credit review for issuers relying on internal or self-liquidity requires additional analysis to determine their ability to honor the demand feature. Investor confidence in an obligor's ability to honor the demand feature is built on evidence of: sufficient liquid assets, ability to generate operating cash, management experience, and proof of the investment manager's expertise. The focus on this section is the additional analysis to determine that an obligor has the ability to fund the demand feature.

##### ***a) Official Statement Disclosure***

- The Offering Memorandum should include the content that is identified in the NFMA Recommended Best Practices for that particular specific sector
- The most recent audit should be included in the Offering Memorandum, as well as the most recent monthly or quarterly financial information (this does not need to be audited). The more recent information is particularly crucial at times when the most recent audit addresses a fiscal year that has ended more than six months previously. The unaudited information should parallel the information provided in an audit as closely as possible, (ie., a balance sheet and statement of revenues and expenses).
- Additional discussion should be included about the management team with responsibility for the investment function, specific to the short term monitoring and management of the portfolio.
- The Offering Memorandum should identify the sources which are legally available to pay bondholders and which of them are liquid, such as operating or maintenance reserve funds, internal service funds or capital project funds, with up-to-date available assets as well as projections through the fiscal year-end. Projections are particularly necessary when capital project funds are identified as a source of liquidity.

- An asset allocation breakdown of all funds the obligor has stated are available to meet the liquidity needs should be included, specifically: Cash, Treasuries, Agencies, Corporate Bonds, Equities, and if held in mutual funds what type, etc. The breakdown should also include the amount of liquidity available within one day and one week. Information from the Obligor's Investment Policy on diversification, maturity and credit quality should be included. Investment Policy disclosure should specifically address the allowed use of securities lending and derivatives. It should also indicate whether the investments are managed by internal or external fund managers. Please see the attached Appendix 1 for an example of detailed description of available assets.
- The obligor should identify those assets that are deemed liquid enough to satisfy the demand feature along with the relevant credit quality and maturity characteristics.
- Include information about any direct lines of credit (not associated with a transaction) to which the obligor has access and which could be available for liquidity purposes.
- There should be a discussion of the process and timing necessary to access the assets the Obligor has deemed liquid and available to satisfy the demand feature. The ability to quickly access these assets is critical, as often the payment for the demand feature must be made the same day that the Obligor has received notice of the failed remarketing. For example, it should be noted that if the funds are held in a separate foundation, the need to transfer to the obligor's accounts and the timing required to effect the transfer.

#### ***b) Continuing Disclosure***

- Rely on NFMA Recommended Best Practices for the applicable sector.
- Quarterly statements should be made available to investors and to the NRMSIRs within 60 days of the end of each fiscal quarter to allow them to make their required determinations of creditworthiness and to analyze the obligor's ability to honor any demands.
- Quarterly disclosure should include detail, not net numbers, on both realized and unrealized gains and losses. A discussion of credit quality and weighted average maturity by asset class should also be included if the investments include direct obligations.
- Explanations for any material interim budget variances that have occurred should be provided, not just a statement that variances have occurred.



- Any material changes to the sources of liquidity disclosed in the Offering Memorandum should be discussed.
- Any material changes in the process or timing of access to assets to meet liquidity needs should be disclosed and discussed.
- Any material changes to the Obligor's financing plans subsequent to the Offering Memorandum should be discussed.
- Any changes in the Obligor's Investment Policy, including any change in internal or external fund managers.
- Any disclosure should pertain to the specific obligor, not to a corporate affiliate that is not obligated to repay the security (e.g., disclosure updates about an obligor that is a subsidiary of a holding company should not be made by reference to the holding company's financial statements or other data relating to the holding company.)

## **C. Short-Term Fixed Rate Notes**

This section discusses the disclosure items that should be included in official statements for Bond Anticipation Notes and cash flow notes such as Tax Anticipation Notes, Revenue Anticipation Notes and Tax & Revenue Anticipation Notes. These sections refer specifically to primary market disclosure as these notes typically mature in less than thirteen months. However, as discussed in each section, obligors are encouraged to disclose any material changes that occur during the life of the notes. This is particularly true for Bond Anticipation Notes, as material changes must be disclosed in the offering statements issued for renewal notes or for replacement Bonds, and surprising information released in these subsequent documents may result in unexpected market consequences.

- Section 1 discusses the disclosure items that are specific to the issuance of Bond Anticipation Notes beyond the general items that are covered in the General Obligation or other sector disclosure Paper.
- Section 2 discusses the disclosure items that are specific to the issuance of cash flow notes such as Tax Anticipation Notes, Revenue Anticipation Notes and Tax & Revenue Anticipation Notes beyond the general items that are covered in the NFMA Recommended Best Practices for General Obligation and Tax-Supported Debt, or other sector best practices papers.

## **1) Bond Anticipation Notes (BANs)**

### ***a) Security***

- Identify the revenue sources (distinguishing between limited and unlimited tax pledges) or future debt specifically securing the notes, dated and maturity dates, interest payment dates, trustee or paying agent, and bond counsel. If the issuer has long-term ratings securing debt from the same revenue stream that will repay the notes, include the long-term ratings. Indicate whether or not the notes will be rated.
- Discuss the authorizing purpose for the notes, including the state or local statute permitting its issuance and reference to any associated resolutions. Include information regarding the projects that the note proceeds are intended to fund; a detailed list is appreciated but not necessary, however more information than “Various capital improvements” should be included.
- Indicate whether a voter referendum has occurred to approve the debt sale, as well as the support rate for the referendum.
- If the anticipated long-term debt will be subject to a specific program such as a state intercept program or building aid program, give a brief indication of such with specific details of the requirements the issuer must accomplish to participate in the program.
- Indicate plans for repayment of the notes, whether from future notes (include legal ability to refinance notes and the limitations thereon), long-term debt or cash, as well as the repayment schedule. If the note issuance is intended to refinance an existing note, include information on the number of previous refinancings, any pay downs of the original issuance amount as well as future refinancing plans, as above.

### ***b) General Economy & Finances***

This should include all the information that would be included in an offering statement for long-term debt, either general obligation or revenue debt. Please see the appropriate NFMA Recommended Best Practices for a more detailed discussion, but generally the following items should be incorporated:

- Discussion of demographic and economic information such as population trends, labor force trends, employment sector trends, largest employers, per capita and/or household income information, retail sales trends.

- Property assessment trends, tax collection rates, tax levy amounts (millage rates), responsible tax collection agency (county, local government). Discuss reassessment activity or major appeals.
- A chart incorporating three to five years of general (or appropriate enterprise) fund statements of income and expenditures, and changes in fund balance; as well as one with similar balance sheet information. A brief management discussion of financial trends to include explanation of growth or declines in revenue or expenditure items; policy regarding use of fund balances. The current and forthcoming year's budget (as available). If the note issuance is to occur near the end of the fiscal year, please include an update of the budget to date or to the last quarter.
- Discussion of debt trends to include total outstanding debt, authorized but unissued debt, debt limitations, self-liquidating debt, overlapping debt. This should include information regarding both long-term and short-term debt, (BANs, RANs, etc), including a discussion of prior access to the capital markets (generally, the number of bids previous sales have received). An amortization schedule for all outstanding debt should also be included.
- A complete copy of the most recent audited financial statements, including auditor's letter, management letter (as discussed under GASB 34), financial statements and associated notes and supplementary information.
- Discussion of any debt-related or other litigation, as well as any potential legislative events that could affect outstanding or future debt.
- Issuers should indicate their willingness to disclose material events on an on-going basis.

## **2) Cash Flow Notes**

### ***a) Security***

- General discussion of the Notes to include dated and maturity dates, interest payment dates, trustee or paying agent, and bond counsel. If the obligor has long-term ratings securing debt from the same revenue stream that will repay the notes, include the long-term ratings. Indicate whether or not the notes will be rated.
- Legal authority to issue cash flow notes, including the legal requirements or restrictions governing the sizing of the notes, as well as the need for the notes. If an obligor or pool participant is subject to a revenue intercept, include an

explanation of the process and legal requirements under which the intercept is utilized.

- If the issue includes more than one participant, clearly delineate each participant's level of participation in the transaction as well as its financial obligation and whether the transaction includes any cross-collateralization among the participants. Include any legal restrictions or limitations on the proportionate size of any individual obligor. For diversification purposes, money funds are required to account for a pool participant that represents 10% or more of a transaction.
- Discuss the authorizing purpose for the notes, including the state or local statute permitting its issuance and reference to any associated resolutions, as well as the timeline for repayment. If notes are being issued prior to budget adoption (or prior to resolution of external revenue sources, i.e., state funding), indicate the financial impact of delayed budget or revenue stream resolution.
- Any legal requirements regarding segregation of funds (set-asides), should specify the dates and amounts of segregation, as well as where the funds are to be deposited (issuer's segregated account, trustee or paying agent). This discussion should be reflected in the actual cash flows as to timing and amount of segregation.
- If the transaction includes a reserve fund or first-loss guarantee, include a discussion of how the level of reserves or guarantee was determined, as well as the procedure and timing for accessing those funds in the event of a shortfall in payments.
- Include plans for investment of note proceeds prior to draw down as well as investment of note repayment amounts prior to maturity, (i.e., investment contract, local or state investment pool, US government obligations). In addition, discuss restrictions on use of segregated funds.

#### ***b) General Economy and Financial Information***

- Discussion of demographic and economic information such as population trends, labor force trends, employment sector trends, largest employers, per capita and/or household income information, retail sales trends.
- Provide detailed cash flows with actual results for the past year, actual/projected results for the current year and projections for the year in which the notes will be repaid. See Appendix 2 for an example of Recommended Best Practices for cash flows. They should include:
  - The deposit of the note proceeds, as well as the segregations or repayment of the notes at the appropriate dates.

- Details on revenue streams (property taxes, sales taxes, state aid, federal aid, transfers from other funds) as appropriate, and similar detail on expenditures (salaries, benefits, functional spending (education, community services, healthcare), etc) as appropriate. (If a particular revenue or expenditure represents more than 10% of the budget, provide it as a separate line item in the cash flow). If cash flows vary significantly from GAAP or budget materials, provide a brief explanation. Similarly, if individual revenue or expenditure lines increase or decrease by more than 10% from one year to the next, provide a brief explanation.
- Other available internally borrowable resources on a monthly basis. If these resources come from more than one source, provide a breakout of the sources (i.e., special revenue fund, capital projects fund). Include any legally required repayment date for these resources, as well as details on how they are invested.
- Include the current and forthcoming years' budgets with detail comparable to the cash flows. Please indicate if cash flows are produced prior to passage of the next year's budget. If the note issuance is to occur near the end of the fiscal year, please include an update of the current budget to date.
- Include a chart incorporating three to five years of general (or appropriate enterprise) fund statements of income and expenditures, and changes in fund balance, as well as a chart with similar balance sheet information. A brief management discussion of financial trends should include an explanation of growth or declines in revenue or expenditure items. The discussion should define the policy regarding use of fund balances.
- Provide a chart with three to five years of historical cash flow borrowings to indicate trends in sizing.
- The official statement should include the most recent audited financial statements, including auditor's letter, management letter (as discussed under GASB 34), financial statements and associated notes and supplementary information.
- If cash flow notes are to be repaid with a specific revenue stream, indicate the historical collection rate and levy rate. Property assessment trends, tax collection rates, tax levy amounts (millage rates), responsible tax collection agency (county, local government). Discuss reassessment activity or major appeals.

- Provide a discussion of debt trends to include total outstanding debt, authorized but unissued debt, debt limitations, self-liquidating debt, overlapping debt. This should include information regarding both long-term and short-term debt, (BANs, RANs, etc) and a discussion of any debt-related or other litigation, as well as any potential legislative events that could affect outstanding or future debt.
- Issuers should indicate their willingness to disclose material events on an on-going basis. This could take the form of a quarterly update of cash flows with particular discussion of significant variations from the original projections. These updates should be provided to the NRMSIRs for dissemination to the marketplace.

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## **APPENDIX 1**

### **Description of Available Assets**

#### **XYZ Medical Center**

A. Liquid Assets, these assets are available at face value, at any time. (1)

Cash	\$ 10,234,000
Certificate of Deposit	\$ 12,250,000
Treasuries (1.2 WAM)	\$ 20,000,000
Corp. Bonds (7.9 WAM) (Avg Rating A)	\$ 25,000,000
Govt. Sec. Mutual Fund	\$ 45,000,000
Corp. Bond Mutual Fund	\$ 40,567,000
Equity Mutual Fund	<u>\$ 35,000,000</u>
<b>Subtotal</b>	<b><u>\$188,051,000</u></b>

B. Other Assets

Annuity (2)	\$ 1,500,000
Foundation (3)	\$ 25,000,000
<b>Misc. Real Estate (4)</b>	<b><u>\$ 13,000,000</u></b>
Physical Stock Certificate (5)	<u>\$ 3,500,000</u>
<b>Subtotal</b>	<b>\$ 43,000,000</b>

Total \$231,051,000

WAM is the weighted average maturity, please specify days or years.

- (1) XYZ Medical Center has a line of credit with Community Bank for \$15,000,000. At this time they have not drawn down any of this line of credit.
- (2) The income on this annuity goes to the donor; the principal balance is available only after the donor dies.
- (3) Foundation assets are available only upon appropriation at the quarterly board meeting.
- (4) These are income producing real estate assets. Liquidation of these assets at fair market value could take an extended time.
- (5) A gift of stock from a board member – the stock is currently subject to trading restrictions.

## APPENDIX 2

### NFMA Recommended Best Practices for Cash Flow Notes

Fiscal 200x, ending June 30

(\$mils)	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	TOTAL
Beg. Cash Balance	45.6	86.7	81.6	67.5	54.3	46.6	74	90.4	97.4	92.9	73.1	53.2	
REVENUES													
Property taxes	24.5	19.5	10.2	9.8	15.9	50.4	39.5	29.3	18.5	17.1	16.2	49.5	300.4
Sales taxes	12.6	11.5	12	13	14.1	15.1	20.3	15	15.1	16.4	17.1	17.5	179.7
Licenses & fees	5.6	5.4	5.6	4.9	4.8	4.7	3.5	2.9	2.8	3.5	3.6	3.5	50.8
Investment income	1.8	1.7	1.6	1.5	1.4	1.3	1.5	1.8	1.9	1.8	1.7	1.6	19.6
All other revenues	17.5	18.5	18	17.9	16.5	17	16.5	16	15.7	16	16.8	16.5	202.9
Note Borrowing	45.6	0	0	0	0	0	0	0	0	0	0	0	45.6
TOTAL REVENUES	107.6	56.6	47.4	47.1	52.7	88.5	81.3	65	54	54.8	55.4	88.6	799
EXPENDITURES													
Salaries	31.2	31.5	32	31.1	31.5	32	31.2	30.9	31.5	31.3	32	31.5	377.7
Operating Costs	25.4	26.1	25.3	25.2	25.1	26.2	27	26	25.1	25.8	25.2	26.1	308.5
Capital projects	5.4	4.1	4.2	4	3.8	2.9	1.9	1.1	1.9	2.5	3.1	4.2	39.1
Debt service	4.5	0	0	0	0	0	4.8	0	0	0	0	0	9.3
Note repayment	0	0	0	0	0	0	0	0	0	15	15	15.9	45.9
TOTAL EXPENDITURES	66.5	61.7	61.5	60.3	60.4	61.1	64.9	58	58.5	74.6	75.3	77.7	780.5
Monthly surplus/shortfall	41.1	-5.1	-14.1	-13.2	-7.7	27.4	16.4	7	-4.5	-19.8	-19.9	10.9	18.5
Ending Cash	86.7	81.6	67.5	54.3	46.6	74	90.4	97.4	92.9	73.1	53.2	64.1	
Other borrowable resources	44.8	44.8	46	46.8	47.2	45.1	46.2	46.3	43.5	44.2	43.2	45.8	

## **APPENDIX 3**

### **Rule 2a-7**

#### **Rule 2a-7 -- Money Market Funds**

a. Definitions.

1. Acquisition (or Acquire) means any purchase or subsequent rollover (but does not include the failure to exercise a Demand Feature).
2. Amortized Cost Method of valuation means 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 means 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 which consist of Qualifying Assets (as defined in this paragraph). Special Purpose Entity means a trust, corporation, partnership or other entity organized for the sole purpose of issuing securities that 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 means 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 means any day, other than Saturday, Sunday, or any customary business holiday.
5. *Collateralized Fully* means "Collateralized Fully" as defined in [Rule 5b-3\(c\)\(1\)](#).
6. Conditional Demand Feature means a Demand Feature that is not an Unconditional Demand Feature. A Conditional Demand Feature is not a Guarantee.
7. Conduit Security means 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 means 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 means:

- 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 means a Demand Feature issued by:

- i. 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 (control means "control" as defined in [section 2\(a\)\(9\)](#) of the Act; or
- ii. A sponsor of a Special Purpose Entity with respect to an Asset Backed Security.

10. Eligible Security means:

- i. A Rated Security with a remaining maturity of 397 calendar days or less that has received a rating from 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 for a Rated Security in 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 from an NRSRO or the Guarantee is issued by a guarantor that has received a rating from an NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security to the Guarantee, unless:
    - 1. 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 (other than a sponsor of a Special Purpose Entity with respect to an Asset Backed Security);
    - 2. The security subject to the Guarantee is a repurchase agreement that is Collateralized Fully; or
    - 3. The Guarantee is itself a Government Security; 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* means "Event of Insolvency" as defined in [Rule 5b-3\(c\)\(2\)](#).

12. First Tier Security means any Eligible Security that:

- i. Is a Rated Security that has received a short-term rating from 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 for a Rated Security in 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 means a security the terms of which provide for the adjustment of its interest rate whenever a specified interest rate changes and that, 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. Government Security means any "Government security" as defined in [section 2\(a\)\(16\)](#) of the Act.

15. Guarantee means 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), 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).



16. Guarantee Issued By A Non-Controlled Person means a Guarantee issued by:
- i. 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 (control means "control" as defined in [section 2\(a\)\(9\)](#) of the Act; or
  - ii. A sponsor of a Special Purpose Entity with respect to an Asset Backed Security.
17. NRSRO means any nationally recognized statistical rating organization, as that term is used in paragraphs (c)(2)(vi)([E](#)), ([F](#)) and ([H](#)) of Rule 15c3-1 of this Chapter, that is not an "affiliated person," as defined in [section 2\(a\)\(3\)\(C\)](#) of the Act, of the issuer of, or any insurer or provider of credit support for, the security.
18. Penny-Rounding Method of pricing means 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. Rated Security means a security that meets the requirements of paragraphs (a)(19)(i) or (ii) of this section, in each case subject to paragraph (a)(19)(iii) of this section:
- i. The security has received a short-term rating from an NRSRO, or has been issued by an issuer that has received a short-term rating from an NRSRO 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
  - ii. The security is subject to a Guarantee that has received a short-term rating from an NRSRO, or a Guarantee issued by a guarantor that has received a short-term rating from an NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security with the Guarantee; but
  - iii. A security is not a Rated Security if it is subject to 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 was assigned its rating, unless the security has received a short-term rating reflecting the existence of the credit support agreement as provided in paragraph (a)(19)(i) of this section, or the credit support agreement with respect to the security

has received a short-term rating as provided in paragraph (a)(19)(ii) of this section.

20. *Refunded Security* means "Refunded Security" as defined in [Rule 5b-3\(c\)\(4\)](#).
21. *Requisite NRSROs* means:
- 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.
22. *Second Tier Security* means any Eligible Security that is not a First Tier Security. *Second Tier Conduit Security* means any Conduit Security that is an Eligible Security that is not a First Tier Security.
23. *Single State Fund* means 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.
24. *Tax Exempt Fund* means any money market fund that holds itself out as distributing income exempt from regular federal income tax.
25. *Total Assets* means, 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.
26. *Unconditional Demand Feature* means 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.
27. *United States Dollar-Denominated* means, 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.
28. *Unrated Security* means a security that is not a Rated Security.

29. Variable Rate Security means 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 that, 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 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, 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 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 that 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 that suggests that a registered investment company is a money market fund or the equivalent thereof shall include one that 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" or "fund"), notwithstanding the requirements of [section 2\(a\)\(41\)](#) of the Act and of [Rule 2a-4](#) and [Rule 22c-1](#) there under, 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 that 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 that 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 that 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;
  - 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, from 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 NRSROs' 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 that 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 that 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 the escrowed Government Securities.
- C. Conduit Securities. A Conduit Security shall be deemed to be issued by the person (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 Acquired by a fund ("Primary ABS") shall be deemed to be issued by the Special Purpose Entity that issued the Asset Backed Security, Provided, however:
    - i. Holdings of Primary ABS. Any person whose obligations constitute ten percent or more of the principal amount of the Qualifying Assets of the Primary ABS ("Ten Percent Obligor") shall be deemed to be an issuer of the portion of the Primary ABS such obligations represent; and
    - ii. Holdings of Secondary ABS. If a Ten Percent Obligor of a Primary ABS is itself a Special Purpose Entity issuing Asset Backed Securities ("Secondary ABS"), any Ten Percent Obligor of such Secondary ABS also shall be deemed to be an issuer of the portion of the Primary ABS that such Ten Percent Obligor represents.
  2. Restricted Special Purpose Entities. A Ten Percent Obligor with respect to a Primary or Secondary ABS shall not be deemed to have issued any portion of the assets of a Primary ABS as provided in paragraph (c)(4)(ii)(D)(1) of this section if that Ten Percent Obligor is itself a Special Purpose Entity issuing Asset Backed Securities ("Restricted Special Purpose Entity"), and the securities that it issues (other than securities issued to a company that controls, or is controlled by or under common control with, the Restricted Special Purpose Entity and which is not itself a Special Purpose Entity



issuing Asset Backed Securities) are held by only one other Special Purpose Entity.

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 of Other Money Market Funds. A money market fund that Acquires shares issued by another money market fund in an amount that would otherwise be prohibited by paragraph (c)(4)(i) of this section shall nonetheless be deemed in compliance with this section if the board of directors of the Acquiring 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, or with respect to a Guarantee or Demand Feature that is itself a Government 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.
  - 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 paragraphs (c)(4) and (c)(5) of this section shall be deemed to have satisfied the diversification requirements of [section 5\(b\)\(1\)](#) of the Act and the rules adopted there under.
- 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 1/2 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 or electronic mail, 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 that 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 1/2 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, and that 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 that 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 is not subject to 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; Provided, however, written procedures need not require periodic determinations with respect to any Asset Backed Security that a fund's board of directors has determined, at the time of Acquisition, will not have, or is unlikely to have, Ten Percent Obligors that are deemed to be issuers of all or a portion of that Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section, and maintains a record of this determination.

#### 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 is not subject to 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 determinations required by [paragraph \(c\)\(9\)\(iv\)](#) of this section (the number of Ten Percent Obligor (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). The written record shall include:
  - A. The identities of the Ten Percent Obligor (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; and
  - B. Any determination that an Asset Backed Security will not have, or is unlikely to have, Ten Percent Obligor deemed to be issuers of all or a portion of that Asset Backed Security for purposes of paragraph (c)(4)(ii)(D) of this section.
- 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 as if such documents were records required to be maintained pursuant to rules adopted under [section 31\(a\)](#) of the Act. 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 1/2 of 1 percent) of this section, the money market fund will file an exhibit to the [Form N-SAR](#) 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 that 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 that 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.

