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BOARD OF DIRECTORS COMPLIANCE ISSUES UNDER RULE 2A-7

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I. Background - Rule 2a-7

Section 2(a)(41) of the Investment Company Act of 1940 (the "1940 Act"), in conjunction with Rules 2a-4 and 22c-1 under the 1940 Act, requires an investment company to calculate its current net asset value per share, for purposes of distribution, redemption, and repurchase, by valuing: (1) its portfolio securities with respect to which market quotations are readily available at current market value; and (2) its other securities and assets at their fair value as determined, in good faith, by the board of directors. Such "fair value" has been interpreted to mean the value that would be received upon the current sale of a security or asset.[1] On May 31, 1977, the SEC issued an interpretive release,[2] expressing the view that money market funds and other open-end investment companies that hold a significant amount of debt securities should: (1) determine the fair market value of short-term debt portfolio securities for which market quotations are not readily available with reference generally to current market factors; and (2) calculate their price per share to an accuracy of within .1% or $.01 based upon a share value of $10.00. Release 9786 indicated further that, because the amortized cost method of valuation would not take market factors into account, the use of that method under all but very limited circumstances would be inconsistent with the provisions of Rule 2a-4 under the 1940 Act. After the issuance of Release 9786, several orders were granted to money market funds to permit the use of amortized cost valuation. In 1982, the SEC proposed for comment Rule 2a-7, which generally codified the terms and conditions of the various exemptive orders.[3] In 1983, the SEC adopted Rule 2a-7.[4]

Rule 2a-7 permits money market funds to maintain a stable share price by using either: (1) the "Amortized Cost Method"[5] of valuation; or (2) the "Penny-Rounding Method"[6] of pricing. In

[1] Investment Company Act Rel. No. 5847 (Oct. 21, 1969) and Investment Company Act Rel. No. 6295 (Dec. 23, 1970).

[2] Investment Company Act Rel. No. 9786 (June 7, 1977).

[3] Investment Company Act Rel. No. 12206 (February 1, 1982) (the "1982 Proposing Release").

[4] Investment Company Act Rel. No. 13380 (July 11, 1983) (the "1983 Adopting Release").

[5] Rule 2a-7(a)(1) defines the "Amortized Cost Method" to mean "the method of calculating an investment company's net asset value whereby portfolio securities are valued at the fund's acquisition cost as adjusted for amortization of premium or accretion of discount rather than at their value based on current market factors."

doing so, Rule 2a-7 exempts money market funds from the general market valuation requirements described above, but contains conditions designed to minimize the deviation between a fund's stabilized share price and the market value of its portfolio. The basic objective of Rule 2a-7 is to control a fund's exposure to credit risk (i.e., the exposure through default or otherwise of instruments in the portfolio to risks associated with the creditworthiness of the issuer of the instrument) and market risk (i.e., the exposure of its portfolio instruments to significant changes in value due to changes in prevailing interest rates).

II. Board's Role Under Rule 2a-7

In promulgating Rule 2a-7, the SEC discussed at various points in the 1983 Adopting Release the role that a board should play to assure compliance with the various conditions of the Rule. Since 1983, a board's role in the 2a-7 process has been interpreted and adjusted in various SEC pronouncements.[7] Throughout the regulatory adjustments, the SEC has recognized that while a board may lack technical expertise and must rely on the investment adviser to provide factual information and advice, the final responsibility for a fund's operations should remain with the board.

Rule 2a-7, while assigning certain matters to the board, does not: (1) require that the board personally become involved in the day-to-day operations of the fund; (2) require the board to be an insurer of the fund or of the fund's investment adviser; or (3) preclude the board from delegating certain duties and functions (to be carried out under its supervision). In supervising a money market fund's operations and delegating special responsibilities involving portfolio management to the fund's investment adviser or other delegate, the board is obligated, as a particular responsibility within the overall duty of care owed to the shareholders, to establish procedures reasonably designed, taking into account current market conditions and the fund's investment objective, to stabilize the net asset value of the fund as computed for the purposes of purchases and redemptions, at $1.00 per share. Rule 2a-7 does, however, mandate that certain findings, determinations and actions be solely within the purview of the board. The following summarizes the various findings, determinations and actions of the board (or, where noted, its delegate) that must be made:

A. **Board Findings [Rule 2a-7(c)(1)]** The board of a money market fund must 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 fund will continue to use such method only so long as the board believes that it fairly reflects the market-based net asset value per share.

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[6] Rule 2a-7(a)(15) defines the "Penny-Rounding Method" to mean "the method of computing an investment company's price per share for purposes of distribution, redemption and repurchase whereby the current net asset value per share is rounded to the nearest one percent."

[7] In a letter dated May 8, 1990 to all money market funds (the "1990 SEC Letter"), the Director of the Division of Investment Management of the SEC sought to clarify certain aspects of the board's role. The Board's role was expanded to address certain technical issues in the 1991 Amendments [Investment Company Act Rel. No. 18005 (Feb. 20, 1991) (the "1991 Adopting Release"); Investment Company Act Rel. No. 17584 (July 17, 1990) (the "1990 Proposing Release")], then again modified in connection with the 1996 Amendments [Investment Company Act Rel. No. 19959 (Dec. 17, 1993) (the "1993 Proposing Release"); Investment Company Act Rel. No. 21837 (Mar. 21, 1996) (the "1996 Adopting Release")].

Comment: A board should make the determination 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 before relying upon the Rule. Thereafter, as part of a regular (e.g., quarterly) review, particularly in connection with the review of market value deviations discussed below, a board should make the determination that $1.00 fairly reflects the fund's market-based net asset value per share.

B. **<u>Portfolio Maturity [Rule 2a-7(c)(2)]</u>**. A money market fund must maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable net asset value per share or price per share: <u>Provided</u>, <u>however</u>, That the money market fund may not:

(1) Purchase any instrument with a remaining maturity of greater than 397 calendar days (except for a fund not using the Amortized Cost Method); or

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

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

Comment: In discussing the portfolio maturity requirement, the SEC stated in the 1983 Adopting Release that:

> **This provision imposes an obligation on the directors of the fund to ascertain that the fund is maintaining an average portfolio maturity that, given the then current market conditions, will permit it to maintain a stable price or net asset value per share. During periods of higher volatility in the market, the board of directors should be aware of the greater difficulty in maintaining a stable price or net asset value per share and should take steps to insure that they are providing adequate oversight to the money market fund.**

In the 1991 Adopting Release, the SEC followed-up this notion stating that a fund:

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

A board should consider, therefore, whether is appropriate to set maturity ranges for the fund, rather than just relying upon the 90-day maximum limit contained in the Rule. In addition, as part of a regular (e.g., quarterly) review process, Rule 2a-7 procedures could require the adviser to report maturity ranges for the fund, such as the "low," "high" and "quarter-end."

C. **<u>Portfolio Quality [Rule 2a-7(c)(3)(i)]</u>**. A money market fund must limit its portfolio investments, including Puts and repurchase agreements, to those United States Dollar-Denominated securities that the fund's board (or its delegate) 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 NRSRO) and which are at the time of acquisition Eligible Securities.

Comment: In discussing the exact role to be played by a board itself in this process, the 1983 Adopting Release stated:

> **The Commission believes that the ultimate responsibility for the quality of portfolio instruments should be placed on the board of directors, who have undertaken special responsibilities designed to ensure stability of the fund. However, as discussed earlier, although the rule provides that the fund will invest only in those instruments which the board has determined to be of sufficient quality, the Commission will not object to the delegation of the day-to-day function of determining quality, provided that the board retains sufficient oversight. An example of acceptable delegation would be for the board to set forth a list of "approved instruments" in which the fund could invest, such list including only those instruments which the board had evaluated and determined presented minimal credit risks. The board could also approve guidelines for the investment adviser regarding what factors would be necessary in order to deem a particular instrument as presenting minimal credit risk. The investment adviser would then evaluate the particular instruments proposed for investment and make only conforming investments. In either case, on a periodic basis the board should secure from the investment adviser and review both a listing of all instruments acquired and a representation that the fund has invested in only acceptable instruments. The board, of course, could revise the list of approved instruments or the investment factors to be used by the investment adviser.**
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> **Again, these examples are not meant to set the exclusive methods by which the board could fulfill its responsibilities. However, they are meant to provide guidance as to what the Commission would consider adequate oversight. Generally, adequate oversight would involve the board satisfying itself in advance that the methods to be used by the adviser in fulfilling the functions are correct, and then reviewing the adviser's actions. However, the Commission is of the view that the board would not be complying with the requirement to review the quality of the fund's portfolio instruments if it merely**

approved the transactions in which the fund engaged, after the fact.

As a practical matter, most boards delegate the minimal credit risk determination requirement to the adviser, subject to board-approved credit guidelines that set forth the analysis to be performed by the adviser. In the 1990 Letter, the Director of the Division of Investment Management of the SEC cited the following examples of elements of a minimal credit risk analysis:

> **(i) a cash flow analysis; (ii) 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; (iii) an assessment of the issuer's liquidity, including bank lines of credit and alternative sources of liquidity, to support its commercial paper; and (iv) a "worst case scenario" evaluation of the issuer's ability to repay its short-term debt from cash sources or asset liquidations in the event that the issuer's backup credit facilities are unavailable.**

Many funds pick up some, or all, of these factors in their credit guidelines. Such credit guidelines are typically reviewed and approved at least annually by the board. Also, many advisers periodically (e.g., quarterly) provide the board with a list of all securities purchased, along with a representation that all such purchases were in accordance with Rule 2a-7 and the board-approved credit guidelines.

D. **Rule 2a-7 Procedures**

1. **<u>Amortized Cost</u>**

(a) **<u>General [Rule 2a-7(c)(6)(i)]</u>**. In supervising a money market fund's operations and delegating special responsibilities involving portfolio management to the money market fund's investment adviser, the fund's board, as a particular responsibility within the overall duty of care owed to its shareholders, must establish written procedures reasonably designed, taking into account current market conditions and the fund's investment objectives, to stabilize the fund's net asset value per share, as computed for the purpose of distribution, redemption and repurchase, at a single value.

(b) <u>Shadow Pricing [Rule 2a-7(c)(6)(ii)(A)]</u>. Written procedures must provide:

(<u>1</u>) That the extent of deviation, if any, of the current net asset value per share calculated using available market quotations (or an appropriate substitute which reflects current market conditions) from the money market fund's amortized cost price per share, shall be calculated at such intervals as the board determines appropriate and reasonable in light of current market conditions;

(2) For the periodic review by the board 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.

Comment: A common practice is for a board to instruct the adviser to calculate the deviation between the amortized cost price per share and the net asset value weekly, with more frequent calculations (e.g., daily) if the deviation exceeds a trigger point (e.g., $.0025 per share). The range of deviations (e.g., "high," "low" and "quarter-end") may then be reviewed by the board quarterly.

A board generally should determine/review the methods used to calculate the deviation at least annually. In lieu of actual market quotations, a fund may use a matrix or valuations from a pricing service. To the extent the board approves these alternative valuation methods, the board should note the SEC's comments in the 1983 Adopting Release that:

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

(c) **Prompt Consideration of Deviation [Rule 2a-7(c)(6)(ii)(B)].** In the event such deviation from the fund's amortized cost price per share exceeds 1/2 of 1 percent, the board must promptly consider what action, if any, should be initiated by the board.

Comment: Such actions may include the sale of portfolio securities prior to maturity to realize capital gains or losses or to shorten average portfolio maturities, withholding dividends, redemption of shares in kind or establishing a net asset value per share by using available market quotations. In fact, most boards have never had to face these decisions because, when funds have come close to "breaking a buck," the adviser has stepped up to bail out the fund.

Although an adviser is not required to bail out a fund, query whether a board, as part of its fiduciary duties to a fund, should consider an adviser's financial capabilities to bail out the fund and set an overall issuer exposure limit at an amount that is reasonable within an adviser's financial capabilities to cover.

While not necessarily coming to that conclusion, the SEC did say in the 1996 Adopting Release:

> **In the case of the bankruptcy of Orange County, most of the funds holding the notes held a fairly small portion of their assets in Orange County notes. As a result, in some cases, the fund could maintain its share price without any assistance from the fund's adviser; in other cases, the adviser was in a position to take steps to prevent the fund from breaking a dollar only because the fund's Orange County Note position was relatively small. While, as the Commission has stated several times, no adviser is required to guarantee its fund against the possibility of breaking a dollar, experience has demonstrated that diversification may not only limit investment risk, but also may place the fund in a better position to address (or avoid) significant deviation between a fund's market-based and amortized cost values.**

(d) **<u>Material Dilution or Unfair Results [Rule 2a-7(c)(6)(ii)(C)]</u>.** Where the board 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.

2. **<u>Penny-Rounding Method [Rule 2a-7(c)(7)]</u>.** 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 fund's investment adviser, the fund's board must undertake 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 fund's investment objectives, that the 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.

3. **Specific Procedures.**

(a) **Securities for Which Maturity Is Determined by Reference to Demand Features [Rule 2a-7(c)(8)(i)].** In the case of a security for which maturity is determined by reference to a Demand Feature, written procedures shall require ongoing review of the security's continued minimal credit risks, which review must be based on, among other things, financial data for the most recent fiscal year of the issuer of the Demand Feature and, in the case of a security subject to a Conditional Demand Feature, the issuer of the security, whether such data is publicly available or provided under the terms of the security's governing documentation.

(b) **Securities Subject to Puts [Rule 2a-7(c)(8)(ii)].** In the case of a security subject to one or more Puts that the board (or its delegate) has determined not to rely upon for purposes of determining the quality, maturity or liquidity of the security pursuant to Rule 2a-7(c)(4)(vi)(B)(4), written procedures shall require periodic evaluation of such determination.

(c) **Adjustable Rate Securities Without Demand Features [Rule 2a-7(c)(8)(iii)].** In the case of a Variable Rate or Floating Rate Security that does not have a Demand Feature and for which maturity is determined pursuant to paragraphs (d)(1) (i.e., Adjustable Rate Government Securities), (d)(2) (i.e., Short-Term Variable Rate Securities) or (d)(4) (i.e., Short-Term Floating Rate Securities), written procedures shall require periodic review of whether the security, upon readjustment of its interest rate, can reasonably be expected to have a market value that approximates its amortized cost.

Comment: This requirement is driven, in part, by the development of inverse floaters, capped floaters, leveraged floaters and other "derivatives," which the SEC in the 1993 Proposing Release said "were developed and purchased by money market funds whose advisers have asserted...meet the definitions of variable or floating rate instruments because they believe they are likely to return to par upon the next interest rate adjustment date." (Emphasis added.) The recordkeeping requirement, in essence, requires an adviser to prove-up its "approximate par" determinations. In response to industry comment that this would impose undue paperwork burdens, in the 1996 Adopting Release, the SEC noted that a fund's board is not required to:

> **maintain a written determination for each *individual* adjustable rate security in the fund's portfolio — it is**

sufficient for the fund to maintain the required record for each type of security (e.g., one record could be maintained for several different adjustable rate securities of similar credit quality whose interest rate readjustment mechanisms are tied to LIBOR plus or minus a number of basis points that make the securities similarly sensitive to interest rate changes).

(d) **Asset Backed Securities [Rule 2a-7(c)(8)(iv)]**. In the case of an Asset Backed Security, written procedures shall require the fund to periodically determine whether a person other than the Special Purpose Entity is the issuer of all or a portion of the Asset Back Security for purposes of the issuer diversification requirements (see, 2a-7 (c)(4)(vi)(A)(4)).

Comment: In essence, a fund is required to treat any person whose obligations constitute 10% or more of the principal of an Asset Backed Security as an issuer, rather than the pool as a whole, for diversification purposes. A board should consider limiting a fund to investing in Asset Backed Securities that are structured such that no obligor will constitute 10% or more of the pool or that specifically identify 10% or more obligors and the amount of their obligations. For some Asset Backed Securities this may be impossible because the obligors may not even be identifiable. If the Asset Backed Security is not structured as noted above, the fund will have to have procedures to periodically (e.g., daily) determine whether any person is a 10% or more obligor.

E. Downgrades, Defaults and Other Events

1. Downgrades

(a) **General [Rule 2a-7(c)(5)(i)(A)]**. Upon the occurrence of either (1) a security ceases to be First Tier[8] or (2) an Unrated or Second Tier Security receives a below Second Tier rating,[9] the board (or its delegate) must reassess promptly whether such security continues to present minimal credit risks and shall cause the fund to take such action as the board (or its delegate) determines is in the best interests of the fund and its shareholders.

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8 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 (or its delegate) determines that the security is no longer of comparable quality to a First Tier Security.

9 A downgrade of an Unrated or Second Tier Security occurs if 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 rating category.

(b) **Securities to Be Disposed Of [Rule 2a-7(c)(5)(i)(B)]**. The reassessment of a security that either (1) ceases to be First Tier or (2) is an Unrated or Second Tier that has received a below Second Tier rating shall not be required if, in accordance with procedures adopted by the board, the security is disposed of (or matures) within five Business days of the specified event and, in the case of a security that is Unrated or Second Tier that receives a below Second Tier rating, the board is subsequently notified of the adviser's actions.

Comment: If a security is A-2/P-2/D-3, it is an Eligible Security. If a security is A-2/P-2, it is an Eligible Security; but if it subsequently is rated D-3 it must promptly be reassessed or disposed of, and in either case, specifically reported to the board.

(c) **Special Rule for Securities Subject to Demand Features [Rule 2a-7(c)(5)(i)(C)]**. 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 board of directors (or its delegate) shall cause the fund to 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 that disposal of the portfolio security would not be in the best interests of the money market fund.

2. **Defaults and Other Events [Rule 2a-7(c)(5)(ii)]**. Upon the occurrence of any of the following events with respect to a portfolio security, the money market fund must 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 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 or the provider of any Put with respect to a portfolio security other than a Put with respect to which a non-reliance determination has been made pursuant to Rule 2a-7(c)(4)(vi)(B)(4).

F. **<u>Securities Subject to Conditional Demand Features [Rule 2a-7(c)(3)(iii)]</u>.** 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:

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

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

(a) 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

(b) 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

(3) (a) If the Underlying Security has a remaining maturity of 397 days or less, the Underlying Security (or the debt securities of issuer of the Underlying Security) has received a short-term rating by the Requisite NRSROs within the NRSROs' two highest short-term ratings 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 fund's board (or its delegate); or

(b) If the Underlying Security has a remaining maturity of more than 397 calendar days, the Underlying Security (or the debt securities of the issuer of the Underlying Security) has received a long-term rating by the Requisite NRSROs within the NRSROs' two highest 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 (or its delegate).

Comment: The requirement that the board determine that there is minimal risk that a Conditional Demand Feature would not be exercisable and that the conditions limiting exercise be readily monitorable is new. To complicate matters, this requirement does not apply to securities issued on or before June 3, 1996. As a practical matter, a board may wish to consider limiting all such securities to having only the following conditions:

(i) a default on a scheduled payment of principal or interest on the underlying security;

(ii) the issuer of the underlying security or the guarantor becoming subject to a bankruptcy, receivership or similar insolvency proceeding;

(iii) a downgrade of the underlying security or a guarantor of the underlying security to below investment grade by the requisite NRSROs; and

(iv) the interest payments on a security which, in the opinion of counsel, are exempt from regular income tax subsequently becoming subject to such a tax as a result of (a) an adverse determination by a court of competent jurisdiction or by the Internal Revenue Service, or (b) a change in applicable law or regulation.

G. **<u>Diversification Calculations - Shares in Master Funds [Rule 2a-7(c)(4)(vi)(A)(5)]</u>**. A money market fund substantially all of the assets of which consist of shares of another money market fund acquired in reliance on section 12(d)(1)(E) of the 1940 Act may be deemed to be in compliance with the diversification requirements of Rule 2a-7 if the board (or its delegate) reasonably believes that the money market fund in which it has invested is in compliance with the diversification requirements of Rule 2a-7.

H. **<u>Put Diversification Calculations - Puts Not Relied Upon [Rule 2a-7(c)(4)(vi)(B)(4)]</u>**. If the fund's board (or its delegate) determines to not rely on a Put to determine the quality (pursuant to Rule 2a-7(c)(3)(ii) or (c)(3)(iii)), or maturity (pursuant to Rule 2a-7(d)), or liquidity of the portfolio security and maintains a record of this determination (pursuant to Rule 2a-7(c)(8)(ii) and (c)(9)(vi)), the Put diversification requirements of Rule 2a-7(c)(4)(v) need not be satisfied as with respect to such put.

I. **<u>Unrated Securities [Rule 2a-7(a)(9) and (11)]</u>**. An Unrated Security that is of comparable quality to a security meeting the requirements of Rule 2a-7(a)(9)(i) or (ii) (i.e., an "Eligible Security") or a security meeting the requirements of Rule 2a-7(a)(11)(i) and (ii) (i.e., a "First Tier Security") as determined by the fund's board (or its delegate) may be treated as an Eligible Security or First Tier Security, as the case may be.

J. **<u>Board Delegation [Rule 2a-7(e)]</u>.** A money market fund's board may delegate to the fund's investment adviser or officers the responsibility to make any determination required to be made by the board under Rule 2a-7 (other than the determinations identified below) provided:

1. **<u>Written Guidelines</u>**. The board establishes and periodically reviews written guidelines (including guidelines for determining whether securities present minimal credit risks as required in Rule 2a-7(c)(3)) and procedures under which the delegate makes such determinations.

2. **<u>Oversight</u>**. The board exercises adequate oversight (through periodic reviews of fund investments and the delegate's procedures in connection with investment decisions and prompt review of the adviser's actions in the event of the default of

a security or Event of Insolvency with respect to the issuer of the security or any Put to which it is subject that requires notification of the Commission under 2a-7(c)(5)(iii)) to assure that the guidelines and procedures are being followed.

K. Board Delegation - Not Delegatable.

A board may not delegate the determinations required by Rule 2a-7(c)(1), (c)(5)(i)(C), (c)(5)(ii), (c)(6)(i), (c)(6)(ii)(A), (B) and (C) and (c)(7), which are:

1. **Board Findings [Rule 2a-7(c)(i)]**. The determination that the fund should maintain a stable net asset value.

2. **Downgrades - Special Rule for Securities Subject to Demand Features [Rule 2a-7(c)(5)(i)(C)]**. The determination to not exercise a Demand Feature or otherwise dispose of the underlying security to bring the fund's exposure to a Second Tier Issuer under 5% of Total Assets.

3. **Defaults and Other Events [Rule 2a-7(c)(5)(ii)]**. The determination to not dispose of a security that (A) is subject to default, (B) ceases to be an Eligible Security, (C) no longer presents minimal credit risks or (D) is affected by an Event of Insolvency with respect to the issuer of or provider of any Put with respect to the security (other than a Put not relied upon pursuant to Rule 2a-7(c)(iv)(B)(4)).

4. **Approval of Rule 2a-7 Procedures - Amortized Cost [Rule 2a-7(c)(6)(i)]**. The approval of Rule 2a-7 Procedures for a fund relying upon the amortized cost method of valuation.

5. Approval of Rule 2a-7 Procedures - Amortized Cost - Shadow Pricing, Prompt Considering of Deviation and Material Dilution or Unfair Results [Rule 2a-7(c)(6)(ii)(A), (B) and (C)]. The duty to determine shadow pricing procedures, review deviations and consider actions relating to deviations in excess of 1/2 of 1% or that may result in material or unfair dilution.

6. **Approval of Rule 2a-7 Procedures - Penny-Rounding [Rule 2a-7(c)(7)]**. The approval of Rule 2a-7 procedures for a fund relying upon the penny-rounding method of valuation.

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