REPORT OF THE STAFF OF THE DIVISION OF INVESTMENT MANAGEMENT OF THE SECURITIES AND EXCHANGE COMMISSION ON THE REGULATION OF MONEY MARKET FUNDS

February 13, 1981

BEFORE THE BUSINESS,
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Money market funds are investment companies which are registered and regulated under the Investment Company Act of 1940 ("1940 Act"). 1/ As open-end, management investment companies, 2/ money market funds make continuous offerings of redeemable shares to the public and stand ready to sell and to redeem these shares daily. In issuing their shares to the public, these funds must also comply with the disclosure and antifraud provisions of the Securities Act of 1933 ("1933 Act"). 3/ These statutes are administered by the Securities and Exchange Commission ("Commission").

Over the past six years, money market funds have grown dramatically and, in terms of share ownership, are now the most popular type of investment company in the United States. A recent survey indicates that there are currently 99 such funds with over $86 billion in net assets under management. 4/ These funds offer investors the opportunity to invest in a professionally managed diversified portfolio of short-term debt obligations (money market instruments) such as U.S. Treasury bills and notes, certificates of deposit, bankers' acceptances and commercial paper. The redeemable shares issued by these investment companies represent pro rata interests in the assets of the funds and are sold and redeemed

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1/ 15 U.S.C. 80a-1 et seq.

2/ Section 3(a) of the 1940 Act defines an "investment company" to include any issuer which is engaged primarily in the business of investing, reinvesting, or trading in securities. Section 4(3) of the 1940 Act defines "management company" to include all investment companies other than "face-amount certificate" companies and unit investment trusts. Section 5(a)(1) of the 1940 Act defines "open-end" to describe a type of management investment company which offers for sale redeemable securities.

3/ 15 U.S.C. 77a et seq. The Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. 78a et seq., and the Investment Advisers Act of 1940 ("Advisers Act"), 15 U.S.C. 80b-1 et seq., also apply to the operations of investment companies. For example, the proxy rules adopted under the 1934 Act apply to investment companies, and the antifraud provisions of that Act are also applicable to trading in the shares of such companies. Investment advisers to investment companies must register under the Advisers Act and are subject, among other things, to the antifraud rules adopted thereunder.

4/ Survey by the Investment Company Institute, Wall Street Journal, February 6, 1981.

at current net asset value per share. 5/ Money market funds offer individual investors the opportunity to pool their money to permit the purchase of the currently high yielding large denomination instruments of the money market. To institutional investors, including pension funds and bank trust departments, these funds provide a convenient and economical method for the investment of cash reserves.

This report concerning money market funds ("Report"), prepared by the staff of the Commission's Division of Investment Management ("Division"): (1) outlines the structure and operations of money market funds; (2) outlines the federal regulatory scheme applicable to the operations of these companies; 6/ and (3) discusses specific initiatives of the Commission and its staff relating to the regulation of money market funds.

I. MONEY MARKET FUND STRUCTURE AND OPERATIONS

Money market funds are generally organized as corporations or as business trusts, and are usually organized by individuals associated with an existing company engaged in the business of providing investment management services, such as a brokerage firm or an investment adviser. This existing "external" company typically enters into a contract with the fund to provide investment advice and management services, and persons associated with this external investment adviser generally serve

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5/ Section 2(a)(32) of the 1940 Act defines "redeemable security" as any security which entitles the holder of such security to receive approximately his proportionate share of the issuing company's current net assets or the cash equivalent thereof. As discussed at page 9, *infra*, the Commission's rules require that sales and redemptions of investment company shares be effected at current net asset value per share to insure that investors pay no less upon purchase, and receive no more upon redemption, than their pro rata interest in the investment company.

6/ In addition to the provisions of federal law, money market funds are subject to state corporation laws and state laws regulating the issuance of securities ("blue sky" laws).

as directors of the investment company. 7/ The use of external services in this manner is not unique to money market funds, but rather is characteristic of the structure of the investment company industry generally. In part, it was this structure and its potential for abuse and overreaching that led to the enactment of the 1940 Act.

Shares sold by a money market fund to the public represent equity ownership interests in the fund (common stock). The capital raised from the sale of shares is invested by the fund in money market instruments, and the return from the fund's investments, net of fund expenses, is distributed to shareholders in the form of dividends. 8/ Whereas the typical open-end investment company invests its assets in equity securities and distributes its net earnings quarterly, the typical money market fund distributes its net earnings in the form of dividends which are declared daily and which can be reinvested in additional shares. 9/

7/ As discussed at page 7, infra, the 1940 Act imposes certain limitations on the percentage of directors of an investment company that may be associated with the investment adviser of that investment company. Investment advisers are typically compensated through an advisory fee calculated as a percentage of the investment company's net assets. Typically, this fee amounts to 1/2 of 1 percent per year and, pursuant to the terms of some advisory contracts, this fee is "scaled down" as the net assets of an investment company reach certain specified amounts ("break points"). As discussed at pages 6 and 7, infra, the 1940 Act requires such contracts to meet certain requirements, and specifies the manner by which such contracts must be approved by boards of directors of investment companies and their shareholders.

8/ Subchapter M of the Internal Revenue Code provides, generally, that a "regulated" investment company shall not be treated as a separate taxable entity for federal income tax purposes provided, among other things, that at least 90% of the investment company's taxable income is distributed to shareholders. Shareholders directly pay any federal income tax on the distributions they receive.

9/ Section 19(a) of the 1940 Act and Rule 19a-1 (17 CFR 270.19a-1) require notices of the source of certain dividends to be sent to shareholders. In addition, Section 19(b) of the 1940 Act and Rule 19b-1 (17 CFR 270.19b-1), in effect, prohibit the distribution of long-term capital gains distributions except on an annual basis.

Historically, most investment companies invested primarily in equity securities and long-term debt obligations, and shares of such companies were generally marketed to the public by a principal underwriter through a complex dealer network. These dealers are compensated by the payment of sales charges by investors ("sales loads") ranging as high as 8-1/2 percent of the offering price. Money market funds are distributed at "no-load," and often directly by the fund and its principal underwriter, without the use of a dealer network.

While the similarities between money market funds and equity-oriented investment companies are far greater than their differences, certain features are unique to money market funds. As noted above, money market funds declare dividends daily. In addition, money market funds generally provide expedited means for effecting purchases and redemptions of their shares. By wiring federal funds to a money market fund prior to a specified time, an investor can have his money invested and earning dividends almost immediately. Investors can also remain fully invested until the precise time they require the use of the money they have invested by effecting redemptions by telephone and having the proceeds wired by the money market fund to a predesignated bank account. Another means of redemption generally offered by money market funds is redemption by means of drafts ("check writing"). To effect this type of redemption, the shareholder writes a check to a third party against a checking account which the money market fund has established with a commercial bank. When the check is presented for payment, the bank, as agent for the redeeming shareholder, effects the redemption of a sufficient number of such shareholder's shares to generate the funds necessary to honor the check, depositing such funds in the money market fund's account with the bank. This method of redemption enables an investor to continue to earn dividends on his investment during the time required for the check to be processed through the banking system.

Perhaps the most unique and innovative feature of many money market funds is the maintenance of a stable net asset value per share. 10/ This feature, which gives investors the convenience of being able to purchase and to redeem shares at a fixed price absent unusual circumstances, is apparently important to many money market fund investors. Thus, while many types of investors are attracted to investment companies generally, and money market funds specifically, to achieve professional management, diversification of risk and liquidity of investment, money market funds provide certain additional features and services.

10/ *See* pages 12 to 18, *infra*.

II. REGULATION OF INVESTMENT COMPANIES

Because money market funds maintain continuous offerings of their shares, they are continuously subject to the disclosure and antifraud provisions of the 1933 Act. To satisfy the requirements of the 1933 Act, money market funds must maintain currently effective registration statements with the Commission containing specified information. Prospectuses based on these registration statements, which must be provided to investors (preceding or accompanying any other sales materials), contain certain specified information relevant to investors. A prospectus must precede or accompany confirmations of the purchase of shares. The adequacy of the disclosure in registration statements and prospectuses is carefully reviewed by the staff of the Division which, generally, offers its informal comments, and these documents must be periodically updated to reflect current information. To prohibit the public sale of securities where disclosure is deficient, the Commission can initiate administrative proceedings to suspend the effectiveness of a registration statement or to suspend the use of a prospectus. 11/ In addition, the 1933 Act provides investors with the right to bring court actions for rescission or damages 12/ and authorizes the Commission to bring injunctive actions to restrain and to prevent violations of that Act. 13/

While the 1933 Act requires disclosure and is applicable to all companies offering securities for sale to the public, the 1940 Act, applicable only to investment companies, is designed to regulate the actual activities and operations of those companies subject to its provisions. To remedy the abuses of the evolving investment company industry, the Congress enacted the 1940 Act to provide a pervasive regulatory scheme for the detailed control of all aspects of the operations of investment companies. A review of some of the provisions of the 1940 Act, relevant to the regulation of money market funds, follows.

11/ Sections 8(d) and 10(b) of the 1933 Act.

12/ Sections 11 and 12 of the 1933 Act provide, generally, for shareholder rights of action in the event a security is sold without registration or compliance with the applicable prospectus requirements of the 1933 Act (except where an exemption from registration is available), or in the event a prospectus includes a material misstatement or omits to state a material fact.

13/ Section 20(b) of the 1933 Act.

A. Investment Policies

Investment companies may generally pursue the investment policies and goals of their choosing. However, the 1940 Act requires that investment companies recite, in their registration statements, their investment objectives and all of their fundamental policies. 14/ Once an investment company has stated these objectives and policies, a majority vote of shareholders is generally required in order for those objectives or policies to be changed. 15/ In the case of money market funds, the declared investment objective is typically to seek maximum safety consistent with achieving high current income.

B. Investment Advisory Contracts

The 1940 Act makes it unlawful for any person to serve as investment adviser of a registered investment company except pursuant to a written contract which: (1) has been approved by a vote of a majority of the outstanding voting securities of the company; (2) precisely describes all compensation to be paid; and (3) continues in effect for not more than two years unless continuance of the contract is specifically approved annually by the board of directors or a majority vote of the outstanding shares of the investment company. 16/ The contract must also provide that it may be terminated without penalty by the board of directors, or a majority vote of the outstanding shares, on not more than 60 days' written notice to the investment adviser and must provide for its automatic termination in the event of its assignment. 17/ Similar requirements apply to the terms and approval of underwriting contracts. 18/ In addition to these requirements, upon the execution or renewal of advisory and underwriting contracts, the terms of such contracts must be approved by a majority vote of those directors of the investment company who are not parties to the contract or interested persons of any such party, and such votes must be cast in person at a meeting called for the purpose

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14/ Section 8(b) of the 1940 Act.

15/ Section 13(a) of the 1940 Act.

16/ Section 15(a) of the 1940 Act.

17/ *Id.*

18/ Section 15(b) of the 1940 Act.

of voting on such approval. 19/ The 1940 Act also generally requires that all directors be elected by shareholder vote 20/ and requires the annual election by shareholders of an independent auditor to certify financial information furnished to shareholders and filed with the Commission. 21/

C. Independent Directors

The interests of investors in investment companies are further protected by a requirement that, generally, no more than 60 percent of the board of directors be composed of persons who are "interested persons" of the investment company. 22/ Several provisions of the 1940 Act require certain matters to be approved by a majority of the "disinterested" directors, 23/ and they serve to protect against the possibility of overreaching by those who are affiliated with the investment company or its investment adviser.

D. Affiliated Transactions

The history of the operation of investment companies prior to the 1940 Act indicated that affiliated persons of such companies frequently took advantage of their positions in effecting transactions with investment companies. The 1940 Act addresses the abuses of these "affiliated transactions" by prohibiting specified "affiliated persons" from engaging, either as principal or as a joint participant, in transactions with the

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19/ Section 15(c) of the 1940 Act. The term "interested person" includes any employee, officer or director of the investment company, or of its investment adviser or principal underwriter, among others. Section 2(a)(19) of the 1940 Act.

20/ Section 16(a) of the 1940 Act.

21/ Section 32 of the 1940 Act.

22/ Section 10(a) of the 1940 Act. Under certain circumstances, no more than 50 percent of the directors may be interested persons of the investment company. Section 10(b) of the 1940 Act. However, under certain unique circumstances where the potential for abuse is minimal only one director need not be an interested person of the investment company. Section 10(d) of the 1940 Act.

23/ Sections 15(c), 16(b) and 32(a) of the 1940 Act.

investment company which have the potential for abuse or overreaching. 24/ Those prohibited transactions are permissible only by order of the Commission, upon the filing of an application which demonstrates that the proposed transaction satisfies certain standards of fairness. 25/ In addition, the Commission has issued rules permitting certain affiliated transactions where the potential for overreaching is minimal. 26/

E. Capital Structure

Other provisions of the 1940 Act are designed to eliminate the risks associated with certain types of capital structures. Open-end investment companies are generally prohibited from issuing any class of senior securities (*i.e.*, any securities other than common stock), although borrowing from a bank is permitted provided that an asset coverage of at least 300 percent immediately after such borrowing is maintained. 27/ By limiting the issuance of senior securities, the use of leverage is controlled and the additional risk that would otherwise be imposed on common stockholders, as a result of fixed interest payments to senior securities holders, is eliminated. Pyramiding is effectively prohibited by provisions which generally make it unlawful for an investment company to acquire in excess of three percent of the shares of another investment company. 28/ This prohibition helps to preserve control of an investment company by its public shareholders.

24/ Sections 17(a) and 17(d) of the 1940 Act. Limitations are also placed on the compensation an affiliated person may receive for acting as agent for an investment company by Section 17(e) of the 1940 Act. Section 2(a)(3) of the 1940 Act defines the term "affiliated person" and the prohibitions respecting "affiliated transactions" extend to affiliated persons and affiliated persons of such persons.

25/ Section 17(b) of the 1940 Act; Rule 17d-1 (17 CFR 270.17d-1).

26/ *See e.g.*, Rules 17a-2, 17a-3, 17a-6, 17a-7 and 17a-8 (17 CFR 270.17a-2, 17a-3, 17a-6 17a-7 and 17a-8) and Rule 17d-1.

27/ Section 18(f) of the 1940 Act. Section 18(h) of the 1940 Act defines the term "asset coverage," as here pertinent, to mean the ratio which the value of a company's assets, less all liabilities and indebtedness not represented by senior securities (in this case, indebtedness not due to borrowing from banks), bears to the aggregate amount of senior securities representing indebtedness of such company (the amount borrowed from banks). Thus, a company with assets of $300,000,000 (including amounts borrowed from banks) could have borrowings of no more than $100,000,000.

28/ Section 12(d) of the 1940 Act.

F. Pricing of Investment Company Shares

Of critical importance to an investor in an investment company is the price which must be paid upon the purchase of shares and the amount that will be received upon the redemption of those shares. To the extent that shares are sold at a price too low or redeemed at a price too high, the proportionate interests of other investors are diluted. Pursuant to its statutory authority, 29/ the Commission has adopted rules to ensure that shares are priced in a fair and equitable manner. Investment companies generally are required to calculate their current net asset values per share, the price at which shares are sold and redeemed, at least once daily on any day in which there is a sufficient degree of trading in the investment company's portfolio securities such that the current net asset value per share might be materially affected by changes in value of the underlying portfolio securities. 30/ In addition, a Commission rule specifies the method by which assets are valued and the manner of computation of net asset value per share. 31/ The interests of shareholders and the liquidity of their investments are further protected by a provision which prevents the suspension of the right of redemption and requires payment or satisfaction of redemption requests within seven days after proper tender of a security for redemption. 32/

G. Fidelity Bonding, Custodial Requirements and Code of Ethics

Because an investment company's assets consist primarily of highly liquid securities which could easily be subject to larceny or embezzlement, the 1940 Act requires that all securities and other assets, including cash, be deposited with a qualified custodian pursuant to rules that may be adopted by the Commission. 33/ The rules adopted by the Commission specify procedures to be utilized in safeguarding the assets of investment companies. 34/ In addition, Commission rules require that each investment company maintain specified amounts of fidelity bond

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29/ Section 22(c) of the 1940 Act.

30/ Rule 22c-1 (17 CFR 270.22c-1). The rule provides special exemptions for the pricing of (1) units of unit investment trusts sold in the secondary market and (2) shares sold pursuant to a merger, consolidation or purchase of substantially all the assets of a company which meets the conditions of Rule 17a-8.

31/ Rule 2a-4 (17 CFR 20.2a-4).

32/ Section 22(e) of the 1940 Act.

33/ Section 17(f) of the 1940 Act.

34/ Rules 17f-1, 17f-2, 17f-3 and 17f-4 (17 CFR 270.17f-1, 17f-2, 17f-3, and 17f-4).

coverage in order to protect the company against loss resulting from larceny and embezzlement by an officer or employee of the investment company having access to the assets of the investment company or having the authority to direct the disposition of such assets. 35/ Many funds also maintain errors and omissions policies to protect against other risks. Recently, the Commission also adopted an amendment to one of its rules to require investment companies to adopt a Code of Ethics concerning permissible conduct by the employees. 36/ The amended rule requires that each registered investment company adopt a written code, and institute procedures designed to prevent violations of that code, which contains provisions that will prevent persons with access to certain information from engaging in fraudulent, deceptive or manipulative practices.

H. Required Reports and Records

Rules adopted by the Commission require that investment companies maintain specified books and records relating to their investments, shareholder accounts and other aspects of their operations. 37/ These books and records are subject to inspection by the staff of the Commission. 38/ In addition, the companies are required to file various reports and documents with the Commission, and certain periodic reports and statements must be furnished to shareholders. 39/ These requirements insure that the Commission and shareholders receive important information relating to the operations of investment companies and permit shareholders to make informed investment decisions.

I. Fiduciary Duties, Liabilities and Enforcement

The Commission, as noted above, is authorized by statute to inspect the books and records of registered investment companies. Pursuant to this authority, the Commission's staff, primarily regional office personnel, conduct periodic inspections of the operations and records of investment companies. This inspection program is one of the methods by which the Commission attempts to monitor compliance with the 1940 Act and to remedy

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35/ Rule 17g-1 (17 CFR 270.17g-1).

36/ Rule 17j-1 (17 CFR 270. 17j-1).

37/ Rule 31a-1 (17 CFR 270.31a-1).

38/ Section 31(b) of the 1940 Act.

39/ Section 30 of the 1940 Act and Rules 30a-1, 30a-2, 30b-1, and 30d-1 (17 CFR 270.30a-1, 30a-2, 30b-1 and 30d-1).

compliance deficiencies. In addition, the Commission can conduct formal investigations pursuant to subpoena power. 40/

While many compliance problems are remedied informally, the Commission is authorized to bring administrative proceedings to impose remedial sanctions upon persons associated with investment companies, 41/ and to bring injunctive actions in federal district courts to enjoin continuing and future violations of the 1940 Act. 42/ Private litigation by shareholders has been another useful device operating to achieve compliance. In addition, specific fiduciary duties are imposed by the 1940 Act on certain persons and companies associated with investment companies, 43/ and federal courts have recognized implied fiduciary duties emanating from the provisions of that Act.

J. Summary

While the foregoing is only a brief overview of some of the provisions of the 1940 Act, it illustrates the extensive nature of the regulation of investment companies by the Commission.

III. REGULATION OF MONEY MARKET FUNDS

The unique features and operations of money market funds have given rise to a number of different regulatory issues. These issues have variously been addressed by rulemaking, interpretative releases and the processing of applications seeking exemptive relief. 44/ In addition,

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40/ Section 42(b) of the 1940 Act.

41/ Section 9(b) of the 1940 Act.

42/ Section 42(e) of the 1940 Act. Violations of the 1940 Act can also be prosecuted as criminal actions by the Justice Department. Section 49 of the 1940 Act.

43/ Section 36 of the 1940 Act.

44/ Section 6(c) of the 1940 Act gives the Commission broad authority to exempt persons, securities and transactions from the provisions of that Act and the rules adopted thereunder upon a finding that the granting of an exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the 1940 Act.

regulatory problems have been rectified through inspections and, in some cases, through enforcement actions.

A. Valuation and Pricing

Because the redeemable shares issued by money market funds each represent proportionate interests in the underlying assets of such funds, accurate pricing of such shares for sale and redemption is essential to the sound operation of money market funds. Seemingly small changes in the prices of these shares become significant when translated into rates of return to investors. As noted previously, the stable net asset values per share provided by money market funds are attractive to many investors. Although money market funds have developed several valuation and pricing techniques to achieve stable net asset values per share, the Commission has been concerned that some of these techniques, if not subject to specified conditions, could result in certain inequities or undue risks to investors.

Traditionally, under the applicable rule adopted by the Commission, investment companies have been required to value their assets by reference to their current value. 45/ The rule, which specifies the manner by which investment companies price their redeemable securities for sale and redemption, states that portfolio securities for which market quotations are readily available must be valued at current market value and that other securities and assets be valued at "fair value" as determined in good faith by the board of directors of the investment company. The Commission has interpreted "fair value" to mean the value that would be received upon the current sale of a security or asset. 46/ These valuation principles, by assuring that current net asset value per share reflects current market factors, avoid the potential for dilution of shareholders' interests which could otherwise occur if shares were sold at an understated net asset value per share or redeemed at an overstated net asset value per share.

Pricing shares in the manner described above will ordinarily result in a fluctuating net asset value per share. As the value of an investment company's assets increase through increases in the prices of the investments

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45/ Rule 2a-4 (17 CFR 270.2a-4).

46/ Investment Company Act Release Nos. 5847 (October 21, 1969) and 6295 (December 23, 1970).

it holds (unrealized appreciation), the net asset value per share increases. As the value of its assets decrease through decreases in the prices of the investments it holds (unrealized depreciation), the net asset value per share decreases. 47/

One method of achieving a stable per share price is the utilization of the "amortized cost" method of valuation: portfolio securities are valued by reference to their historic cost (purchase price). Simply stated, under this valuation method a debt security is valued at its cost and the interest to be earned on the security (plus any discount received or less any premium paid upon purchase) is accrued ratably over the remaining maturity of the security. By declaring these accruals to shareholders as a daily dividend, the value of a money market fund's assets and, thus, its net asset value per share, will generally remain constant.

This method, of course, assumes that the investment company will not have to dispose of any of its securities at a gain or loss prior to maturity. In addition, by failing to take unrealized depreciation or unrealized appreciation into account, the net asset value per share of an investment company using amortized cost valuation might not always reflect accurately the value of the underlying portfolio securities. Thus, under some circumstances, the use of this valuation method could result in dilution, and investors would not necessarily be accurately credited with any unrealized appreciation or depreciation experienced by the money market fund during the period they were shareholders in the fund. The magnitude of these distortions would depend upon fluctuations in market rates of interest and the average maturity of the portfolio of the fund. 48/

47/ The price at which short-term debt obligations can be sold may be affected by a variety of factors, including changes in levels of prevailing market interest rates. An increase in interest rates will lower the price of a debt security. A decrease in interest rates will increase the price of a debt security. The greater the remaining maturity of a debt obligation, the greater will be the effect of a given move in interest rates on the price of that instrument. Thus, the longer the average portfolio maturity of a fund investing in debt obligations, such as money market instruments, the greater the impact of fluctuations in interests rates will be on the value of the portfolio.

48/ Id.

Another method of achieving a stable net asset value per share is through the use of "penny rounding" pricing. Under this pricing method, securities are valued at current market value, in accordance with Commission rules; however, unrealized appreciation and depreciation is theoretically reflected in a nominal $1.00 net asset value per share. By "rounding" the net asset value per share to the nearest one cent, fluctuations in the value of the money market fund's assets, which generally do not exceed one half of one cent per share on their short-term portfolios, will not affect the fund's $1.00 price per share. If, for example, the fund's net asset value were $10.00 per share, changes of this magnitude would be reflected in the price of the fund's shares. By artificially setting a $1.00 nominal share value, rather than a $10.00 nominal share value, a money market fund can mask the impact of changes in the value of its portfolio which do not exceed one half of one percent of the value of the fund's assets. 49/ Thus, investors in a fund using penny rounding are generally not credited with unrealized appreciation or depreciation.

The third method of achieving a stable net asset value per share is the "total payout" method. Under this method, the effects of unrealized appreciation and depreciation in the fund's portfolio are reflected in daily dividends by increasing (in the case of unrealized appreciation) or decreasing (in the case of unrealized depreciation) the fund's accrued interest dividend. Unlike the other two methods of stabilizing prices per share, the "total payout" method accurately credits investors with the effect of unrealized changes in the values of funds' portfolios. However, by reflecting these changes in the dividend, the daily dividends declared by a fund using this method can fluctuate significantly from day to day due to the effects of unrealized appreciation or depreciation. Accordingly, many money market funds prefer the use of amortized cost or penny rounding, and the stable dividend stream produced by these methods.

In view of the potential for dilution and other unfair effects existing under the use of amortized cost valuation, in 1975 the Commission proposed a position opposing the use of this valuation method, 50/ and in 1977 an interpretative release was issued expressing the Commission's view that the use of either amortized cost valuation or penny rounding pricing would, generally, henceforth be considered inappropriate. 51/

49/ For example, a net asset value per share of $.996 would be "rounded" to a price of $1.00 (the nearest one cent).

50/ Investment Company Act Release No. 8757 (April 15, 1975).

51/ Investment Company Act Release No. 9786 (May 31, 1977), attached hereto as Exhibit A.

Certain segments of the money market fund industry objected to the Commission's position. One money market fund commenced a lawsuit seeking to restrain the Commission's implementation of its interpretation 52/ and, within six months after the issuance of the interpretative release, 14 money market funds filed applications requesting orders of the Commission exempting the companies, subject to a variety of conditions, from those provisions of the 1940 Act and the rules thereunder which would prohibit the use of amortized cost valuation or penny rounding pricing.

Notices of the filing of these applications were published in the Federal Register and, pursuant to the requirements of the 1940 Act and the Administrative Procedure Act, the notices stated that interested persons could file requests for hearings on the applications. Two money market funds, objecting to certain aspects of the applications, filed requests for hearings. However, before determining whether to grant the requests for hearing, the Commission determined to hold a public meeting on January 26, 1978, to solicit additional views from interested persons concerning the question of money market fund valuation and pricing. 53/ On April 12, 1978, the Commission determined it to be appropriate in the public interest to order a consolidated hearing on the applications. 54/

Prior to the commencement of the hearing, and after extended and intensive negotiations among the applicants, the Division and the parties who had requested the hearing, nine of the applicants entered into an agreement whereby they would amend their respective applications to request exemptions to enable their use of penny rounding, and provide certain specific conditions respecting the use of that pricing method. Generally, the conditions: (1) require that the money market funds not purchase any instrument with a remaining maturity of greater than one

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52/ First Multifund Fund for Daily Income, Inc. v. SEC, [77-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,287 (D.D.C January 20, 1978). The Court's opinion dismissing that action is attached hereto as Exhibit B.

53/ Investment Company Act Release No. 10082 (January 5, 1978), attached hereto as Exhibit C. Temporary orders granting exemptions pursuant to certain conditions were issued with respect to some of the funds that filed applications. See e.g., Investment Company Act Release No. 10027 (November 28, 1977).

54/ Investment Company Act Release No. 10201 (April 12, 1978), attached hereto as Exhibit D.

year and not maintain dollar-weighted average portfolio maturities in excess of 120 days; (2) require that each instrument purchased by the funds meet specific minimum credit requirements; and (3) require that the board of directors of each fund undertake to assure to the extent reasonably practicable that the money market funds' net asset values per share not deviate from $1.00. The Commission carefully considered the amended applications and determined to issue an order permitting the applicant companies to utilize penny rounding pricing under the conditions set forth in the amended applications. 55/ The conditions contained in the order operate to limit the risk that the net asset value per share will deviate materially from $1.00 by: (1) putting limits on the length of the maturities of portfolio securities; 56/ (2) limiting the risk that creditworthiness factors will cause declines in the values of portfolio securities; 57/ and (3) requiring the boards of directors of the funds to manage them in a manner which would, consistent with the funds' investment objectives, minimize the risk of a price movement to $.99 or $1.01.

The hearing proceeded as to the remaining five applicants which had not amended their applications and which continued to seek exemptions to permit the use of amortized cost valuation. 58/ In the course of the hearing, testimony was taken from 14 witnesses and a record of over 2,000 pages was developed on the appropriateness of the use of amortized cost valuation. At the same time, the staff of the Division and the remaining applicants continued discussions of possible conditions pursuant to which the Division would recommend that orders be issued permitting the use of amortized cost valuation.

55/ Investment Company Act Release No. 10451 (October 26, 1978), attached hereto as Exhibit E.

56/ See note 47, supra.

57/ The initial orders permitting the use of penny rounding contained conditions specifying exactly the minimum quality ratings and sizes of the issuers whose instruments could be purchased by the funds. Subsequently, the Commission has issued orders without mandating specific minimums, but rather requiring funds to purchase only those instruments which their boards of directors determine to present minimal credit risk.

58/ One applicant that had requested and received an exemption to permit the use of penny rounding pricing, was reinstated into the hearing to seek an order permitting the use of amortized cost valuation. Investment Company Act Release No. 10612 (February 28, 1979).

Following the conclusion of the evidentiary portion of the hearing, but prior to the issuance of an initial decision by the administrative law judge, the staff of the Division of Investment Management and all but one of the remaining applicants reached an agreement with respect to the appropriate conditions to be attached to the use of amortized cost valuation. Generally those conditions require: (1) an undertaking by the boards of directors of the funds to establish procedures designed to stabilize net asset values per share at $1.00; (2) procedures for review by the boards of directors to determine the extent, if any, of deviations between the amortized cost prices per share of $1.00 and market based net asset values per share; (3) consideration by the boards of directors of the need to take remedial action if such deviation reaches 1/2 of 1 percent; (4) remedial action to be taken by the boards of directors should they determine that any deviation may result in material dilution or other unfair results; (5) the maintenance of a dollar-weighted average portfolio maturity of 120 days or less and the purchase of instruments with remaining maturities not in excess of one year; (6) maintenance of appropriate records; (7) the purchase of portfolio instruments which present minimal credit risks as determined by the boards of directors and are of high quality as determined by a major financial rating service, or if not rated, of comparable quality as determined by the boards of directors; and (8) certain reports to be filed with the Commission. These conditions were presented to the Commission with the favorable recommendation of the Division, and the Commission determined to grant exemptions to permit the use of amortized cost valuation subject to the conditions outlined above. 59/

Subsequently, pursuant to its delegated authority, the staff of the Division has issued numerous exemptive orders to money market funds enabling the use of amortized cost or penny rounding. Based upon the experiences of funds using amortized cost or penny-rounding, the Division continues to believe that the unfettered use of these methods is inappropriate. 60/ However, the Division is confident that such methods, if

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59/ Investment Company Act Release No. 10824 (August 8, 1979), attached hereto as Exhibit F.

60/ The validity of the Commission's concern respecting the use of amortized cost valuation is borne out by the fact that during a period of rising interest rates in late 1978, one fund with an excessive average portfolio maturity experienced a 6% decline in its net asset value when it sold certificates of deposit it had been valuing at amortized cost. This illustrates that the fund's net asset value per share, on an amortized cost basis, had been overstated by six cents on a $1.00 share value. First Multifund Advisory Corp., et al., Investment Company Act Release No. 11064 (March 4, 1980). See page 30 infra.

utilized correctly, will not result in detriment to the investing public. The conditions contained in the exemptive orders were imposed to minimize potential risks and inequities to investors, and the Commission has been closely monitoring the use of these valuation methods, subject to the prescribed conditions, to ensure fairness to investors and to ensure the continued efficacy of the conditions. 61/ The Commission's oversight of the funds using these valuation methods has revealed that, generally, such funds are operating without problems. However, several months ago one fund did experience problems with the use of amortized cost. 62/ In response to the situation, the fund, its investment adviser and principal underwriter, with the consent of the Commission, implemented a special program designed to ameliorate some of the potential problems and inequities that would otherwise result, and permit the fund to continue to value its securities using the amortized cost method, restructure its investments and maintain liquidity. 63/ Under the program the investment adviser and principal underwriter effected an increase in the market-based net asset value per share of this fund, and thereby returned such net asset value to approximately $1 per share, by forgoing certain fees, making a capital contribution to the fund, and by purchasing portfolio securities of the fund at their amortized cost. As a result of the program, this fund's valuation problems were resolved. The Commission, however, is continuing to review this occurence to determine the cause of the valuation problems and to determine whether the conditions of the amortized cost orders are sufficient in this and other situations to avoid future problems.

61/ During October 1980, the Division requested that all money market funds and other short-term funds using amortized cost pricing or penny-rounding submit specified information to the staff to enable it to evaluate the effectiveness of the conditions contained in the exemptive orders and the fairness of these valuation methods to investors.

62/ The market-based net asset value per share of Institutional Liquid Assets ("ILA") deviated by more than 1/2 of 1% from the the net asset value per share calculated using the amortized cost method. At that point ILA's adviser informed the board of trustees that in its view, the good faith fair valuation of the fund, at that time, called for the use of market values for all assets.

63/ See Investment Company Act Release Nos. 11586 (January 27, 1981) and 11388 (October 7, 1980), attached hereto as Exhibit G.

B. Time of Pricing

Investment companies issuing redeemable securities, including money market funds, until August of 1979, had been required to compute current net asset values per share, for purposes of effecting sales and redemptions of their shares, not less frequently than once daily as of the close of trading on the New York Stock Exchange ("NYSE") on each day that exchange was open for trading. 64/ The focus of the rule requiring pricing at such times was on the investment company investing primarily in equity securities listed for trading on the NYSE. One of the purposes of the rule was to enable investors to purchase and to redeem shares of investment companies on each business day the relevant market was open. However, money market instruments are not traded on the NYSE, but rather are bought and sold in an informal dealer market that may be open on days when the NYSE is closed. In addition, the time of the trading day in the money market does not precisely coincide with the time of trading on the NYSE. Because money market funds were required to price their shares, and to effect sales and redemptions, as of the close of trading on the NYSE (4:30 p.m. E.S.T.), redeeming shareholders could not obtain same day access to their funds unless a money market fund adopted procedures to price earlier in the day as well as at the NYSE close. The federal funds wire system closes before the NYSE closes, thus, preventing immediate transmission of redemption proceeds after the typical 4:30 p.m. pricing. By adopting additional pricings at 12 noon, money market funds made it possible for redemption proceeds to be transmitted by federal funds wire on the day of redemption.

In response to this problem and problems for other types of investment companies investing in securities other than those listed on the NYSE, the Commission amended its rule: (1) to require investment companies to calculate net asset value per share at least once daily on each day during which there is a sufficient degree of trading in the relevant markets such that the current net asset value per share might be materially affected, and (2) to require that such calculation be performed at such specific time during the day as determined by a majority of the board of directors. 65/ The rule, as amended, appropriately keys the days of pricing to the days on which money market instruments are traded, and by giving money market fund boards of directors the flexibility to determine the time of the required pricing, eliminates the need for multiple daily pricings of money market fund shares.

64/ Rule 22c-1 (17 CFR 270.22c-1) as in effect prior to August 13, 1979.

65/ Investment Company Act Release No. 10827 (August 13, 1979).

C. Securities Trading Practices

As a result of the review by the staff of the Division of financial information filed by an investment company investing in government securities, the Commission was alerted to certain securities trading practices which raised regulatory questions under the provisions of the 1940 Act designed to limit the issuance of senior securities and the use of leverage. The trading practices involved the use of: (1) reverse repurchase agreements; 66/ (2) "firm commitments"; 67/ and (3) "standby commitments." 68/ The Commission issued a statement

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66/ A reverse repurchase agreement is an arrangement whereby an investment company transfers possession of a government security to another party in return for a loan from the other party in an amount representing a percentage of such security's market value (normally 90-97%). However, the investment company retains ownership of record of the security and the right to receive the interest and principal payments thereon. At the agreed upon date, the investment company regains possession of (repurchases) the security by remitting the proceeds of the loan, plus interest, to the other party. While the instrument need not be government issued, in a typical reverse repurchase agreement the instrument is guaranteed as to principal and interest by the U.S. government, a U.S. agency, or a federally sponsored quasi-public corporation.

67/ A "firm commitment" agreement is a buy order for delayed delivery of an instrument. In that agreement the investment company agrees to purchase the instrument from the seller at a future date, at a stated price and at a fixed yield. The agreement binds the seller to deliver and the buyer to accept the instrument according to the terms of the agreement, irrespective of the impact which intervening changes in prevailing market interest rates may have on the value of the instrument. The agreement generally provides that, on or before the settlement date, the investment company has the option of closing out the obligation, rather than purchasing the instrument, by assigning the contract. This closeout will normally result in an immediate capital gain or loss to the investment company.

68/ A "standby commitment" agreement involves an investment company contractually binding itself, for a fee, to accept delivery of an instrument with a stated price and fixed yield, at a stated future date, upon exercise of an option held by the other party to the agreement. Thus, any upward movement in prevailing market interest rates will have an adverse effect on the market value of the instrument and will result in an immediate capital loss to the investment company when the standby commitment is exercised.

relating to these trading practices expressing its view that each of these practices might involve the issuance of debt or a senior security. The statement further expressed the view that these practices can potentially be employed for speculative or leveraging purposes, and thus may be in contravention of the purposes of Section 18 of the 1940 Act. 69/

One particular situation illustrates the dangers inherent in the use of these trading practices. 70/ In that situation, such trading practices were used by the investment company's portfolio manager without the knowledge or permission of either the board of directors of the investment company or its investment adviser. As a result of the manager's actions, the investment company sustained a loss of approximately $1.5 million which the company disclosed subsequently to shareholders. The investment adviser of the company agreed to reimburse the company for some of its losses.

69/ Investment Company Act Release No. 10666 (April 18, 1979), attached hereto as Exhibit H. The Commission, in addition, has taken a position regarding the valuation of variable rate notes: such notes may be treated as having maturities equal to the period remaining until the next renegotiation of the interest rate where the security itself has a maturity of 180 days or less and the interest rate is renegoitated every 30 days. The Commission is also in the process of formulating a position regarding the purchase of puts by investment companies. A put, sometimes termed a "standby commitment," is an agreement with the seller of a security which enables the purchaser, at his option, to sell back the security at a specified price during a specified time period. In the Commission's view a put is a separate security which must be valued at fair value and is subject to the prohibitions of Section 12 of the 1940 Act prohibiting the purchase of a security issued by a broker or dealer. Therefore the Commission will condone the purchase of puts only under circumstances which will ensure the proper valuation of that security and where exemptive relief is obtained or the put is not purchased from a broker or dealer.

70/ In the Matter of Banker Acceptance Co., et al., Securities Exchange Act Release No. 15974 (June 26, 1979) (Order simultaneouly instituting administrative proceeding and accepting settlement offer), Exhibit I hereto.

D. Switching Services

An additional matter that has been the focus of Commission attention has been the adverse effects which can result from the offering and promotion by investment advisers of "switching" services advising many investors simultaneously of the "appropriate" time to "switch" investments from a money market fund into equity securities or an equity-oriented investment company, and vice versa. In one particular case, the investment adviser of a complex of investment companies encouraged and advocated the use of such services by its shareholders. The extensive use of these services by shareholders resulted in portfolio management problems and increased expenses when a large number of redemption requests were received simultaneously. For example, on one day redemptions resulted in a decline in the net assets of one of the funds in the complex by approximately 70 percent. The Commission instituted an injunctive action against the persons and companies involved in that situation, and secured the appointment of additional independent directors and a special counsel to oversee the operations of the investment companies. 71/

E. Advertising and Sales Literature

The content of money market fund advertising and sales literature, as is the case with respect to any investment company, is subject to the antifraud provisions of Section 17(a) of the 1933 Act and and Rule 10b-5 under the 1934 Act. Under these provisions it is unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails to make representations which are materially misleading in connection with the offer or sale of securities. Representations could be considered to be materially misleading if they (1) contain an untrue statement of a material fact or (2) omit to state a material fact necessary in order to make a statement made, in light of the circumstances under which it was made, not misleading. In addition, because money market funds continuously offer their shares, they are continuously "in registration" under the 1933 Act, and absent Commission rules, would be prohibited from utilizing any advertising or sales literature unless the use of such materials were preceded by, or accompanied with, a prospectus.

71/ Securities and Exchange Commission v. The Fundpack, Inc., et al., (United States District Court for the District of Columbia, Civil Action No. 79-0859). The Court's opinion and final order are attached hereto as Exhibit J.

Rule 134 adopted under the 1933 Act, as now amended, permits specified types of information to be utilized in investment company advertising without being preceded or accompanied by a prospectus. 72/ The scope of the information that can be utilized in investment company advertising under the rule is somewhat broader than the "tombstone" type information to which other issuers of securities are limited in their advertisements. The issuing of securities by an investment company constitutes an important ongoing part of the operations of an investment company. The typical non-investment company issues securities relatively infrequently and generally is free to advertise the business products it offers. However, the product an investment company offers to the public is its shares. Thus, Rule 134 recognizes that an investment company should be able to communicate certain of its features to investors through advertising.

Until March 8, 1979, the content of written advertising and sales literature by money market funds and other investment companies was guided by the Commission's Statement of Policy on Investment Company Sales Literature ("Statement"). That document provided examples of representations which the Commission considered permissible and examples of representations which the Commission believed might violate the anti-fraud provisions of the federal securities laws. The Statement was withdrawn for a variety of reasons, including problems in administering the Statement's provisions, the need for modernization of the Statement due to changes in the nature of the investment company industry, the reluctance of the industry to use presentations unless they were included in the Statement, and the prospect of an increasing role for the Commission and its staff in determining the content of sales literature for the industry. 73/

Following the withdrawal of the Statement, the Commission adopted Rule 156 concerning the use of false and misleading investment company sales literature. 74/ Rule 156 is interpretive in nature and is designed to highlight the types of representations which the Commission's experience suggests are most likely to be misleading.

72/ Rule 134 (17 CFR 230.134).

73/ Investment Company Act Release No. 10621 (March 8, 1979), attached hereto as Exhibit K.

74/ Investment Company Act Release No. 10915 (October 26, 1979), attached hereto as Exhibit L.

Additional action by the Commission has further increased the flexibility and scope of investment company advertising by permitting investment companies to publish a broader range of information than previously permitted, through the use of an "omitting prospectus." 75/ Under the rule, investment companies may include in advertisements appearing in a bona fide newspaper or magazine, or used on radio or television, any information, the substance of which is included in their prospectuses. The availability of the rule is conditioned, among other things, upon the requirement that the advertisement state conspicuously from whom a prospectus containing more complete information may be obtained and that the investor should read the prospectus carefully before investing. Recently, that rule was further amended to provide that any yield figure quoted by a money market fund in such advertisements must be computed according to a standardized method prescribed by Commission rule. 76/ In addition, advertisements pursuant to the rule are subject to the provisions of the 1933 Act, which provides a civil remedy for investors who purchase securities as a result of a false and misleading prospectus. 77/ Such advertisements are also subject to the general antifraud prohibitions of the 1933 Act and those adopted under the 1934 Act.

Written advertising and sales literature utilized by investment companies must be filed with the Commission. 78/ The staff of the Division periodically reviews these materials, which also are generally reviewed during the course of investment company inspections. Where the staff has found misleading advertisements, appropriate action has been recommended to the Commission.

F. Yield Quotations

Due to the nature of money market funds and their investment objective of providing as high a level of current income as obtainable, consistent

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75/ Rule 434d (17 CFR 230.434d). Investment Company Act Release No. 10852 (August 31, 1979), attached hereto as Exhibit M.

76/ Investment Company Act Release No. 11379 (September 30, 1980). See discussion pp. 25-26, infra.

77/ Section 12(2) of the 1933 Act.

78/ Section 24(b) of the 1940 Act.

with preservation of principal, the yield (rate of return), reported by these funds is often of critical importance to investors. However, the Act did not mandate standardization of yield quotes for investment companies in general. The Commission and the staff of the Division were concerned that, due to a lack of uniformity in methods of calculation, yield quotations of money market funds were not comparable and thus, might be confusing or even misleading. In 1975, the Commission proposed to standardize money market fund yield quotations by requiring yield calculations according to the "yield to average life" method. 79/ Comments received on the proposal suggested that the proposed quotation method would not be acceptable to many money market funds because of its complexity. In addition, the variety of valuation and pricing methods then being utilized by funds made the selection of one appropriate method, for all types of money market funds, difficult. However, the resolution of the valuation issues, 80/ resulting in a trend toward money market funds with stable prices per share, and the original adoption of Rule 434d, which enabled advertisements to contain yield quotations, heightened the need for comparable yield quotations and eliminated some of the obstacles to the achievement of that objective.

The Investment Company Institute ("ICI") achieved a consensus of its members concerning the issue of yield quotations and proposed a uniform quotation method for use by its members. The staff of the Division issued a "no-action" position accepting informally the ICI proposal. 81/

On January 22, 1980, the Commission authorized for public comment (1) a proposed amendment to Rule 434d under the 1933 Act which would require that yield quotations included in money market fund advertisements be based on a standardized computation, and (2) a proposed amendment to Form N-1, the registration form for open-end management investment companies, to require the inclusion of a yield quotation based on the standardized computation in the prospectuses of money market funds. On September 30, 1980, the Commission issued a release adopting the proposed amendments, effective November 17, 1980. 82/ The amendments require that

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79/ Investment Company Act Release No. 8816 (June 12, 1975).

80/ *See* pages 14 to 18, *supra*.

81/ Letter from the Division to the Investment Company Institute (available November 16, 1979), attached hereto as Exhibit N.

82/ Investment Company Act Release No. 11379 (September 30, 1980), attached hereto as Exhibit O.

money market fund yields be computed by dividing the average daily net investment income per share earned by the fund (that is, accrued interest income plus or minus amortized purchase premium or discount, less all accrued expenses) during the preceding seven calendar day period, by the fund's average daily price per share over the same period and multiplying the result by 365.

G. Custodial Requirements

As noted above, one provision of the broad regulatory framework of the 1940 Act is designed to protect the typically liquid assets of investment companies from larceny or embezzlement by requiring that every management investment company maintain its securities and other assets pursuant to certain custodial arrangements prescribed by rule. Provided that the requisite conditions are met, the assets of a money market fund may be placed in the custody of a bank, a member of a national securities exchange, or may be held in the custody of the fund itself. The Commission has adopted a rule to permit the assets of investment companies to be deposited in a clearing agency which acts as a securities depository or in the Federal Reserve/Treasury book-entry system. 83/ This rule was adopted to reduce unnecessary costs and to increase the protection of investors by providing a wider variety of efficient, effective and safe procedures for the clearance and settlement of securities transactions, and is particularly significant to money market funds investing in various types of U.S. government securities which are generally kept in book-entry form.

H. Prospectus Disclosure

The Commission is authorized to adopt rules specifying the type of information required to be included in prospectuses utilized by investment companies. 84/ In fashioning such rules, the Commission carefully considers the scope of information that would be material to investors.

On May 31, 1977, the Commission issued a release proposing that money market funds be required to supplement their prospectuses at the end of each calendar quarter with a sticker containing certain unaudited historical information respecting investment performance and portfolio composition. 85/ Consideration of the comment letters on the proposal

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83/ Rule 17f-4 (17 CFR 270.17f-4), Investment Company Act Release No. 10453 (October 26, 1978), attached hereto as Exhibit P.

84/ Section 24(a) of the 1940 Act; Section 10(c) of the 1933 Act.

85/ Securities Act Release No. 5830 (May 31, 1977).

suggested that the burdens and expense that would be imposed by the proposal would outweigh any possible benefits. Thus, the Commission withdrew the proposal. 86/

Nevertheless, the staff of the Division will continue to review the adequacy of the types of information included in money market fund prospectuses to insure that existing disclosure standards require inclusion of information necessary for investors in money market funds. This type of review, as noted above, recently resulted in the Commission adopting a rule to require the inclusion of certain standardized yield information in the prospectuses of money market funds. 87/

IV. INSPECTIONS OF MONEY MARKET FUNDS

Aware of the rapid growth of the money market fund industry during the preceding year, the staff of the Division at the end of 1979 determined that it would be appropriate to conduct limited inspections of virtually all money market funds to assure itself that no significant regulatory problems existed and to ascertain whether these companies were providing adequate service to investors. Thus, on October 30, 1979, the Commission's regional offices were requested to inspect promptly the money market funds located in their respective regions to ascertain: (1) whether sales orders and redemption requests were being processed promptly and properly; (2) whether all cash was being invested promptly and properly; (3) whether funds using "penny rounding" pricing or amortized cost valuation pursuant to exemptive orders were complying with the conditions imposed by such orders; and (4) whether funds were complying with their investment policies and procedures as disclosed to investors in their prospectuses. Although isolated problems were discovered at certain funds, the inspections revealed that the vast majority of money market funds were functioning efficiently and effectively.

A. Back Office Procedures

The inspections revealed that huge influxes of orders resulted in difficulties for some money market funds. One large transfer agent that serves several money market funds appeared to be experiencing difficulties in processing orders to buy and to redeem shares of these funds on a timely basis, particularly in cases where that transfer agent received orders directly from investors rather than from the funds themselves. In the case of another fund, our inspection revealed that

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86/ Securities Act Release No. 6086 (June 8, 1979).

87/ *See* page 25, *supra*.

the fund could not identify almost $20 million of investments that had been received from investors and invested in the fund. Although the money was fully invested from the time of receipt, when investors sought access to their money they would experience some delay because the fund would first have to identify that investor's investment. Investment companies will sometimes receive money for investment which cannot be traced immediately to the proper shareholder account. Where normal processing problems are exacerbated by the relatively rapid turnover in money market fund shareholder accounts, careful attention to back office procedures takes on much greater importance. This fund apparently was unable to devote the manpower and time necessary to identify accounts promptly when money was received. However, this problem was subsequently corrected. In addition, although in several cases money market funds offering to effect redemptions by telephone did not have sufficient telephone facilities to receive such orders without delay, investors in one particular fund were experiencing particularly long delays. The inspection staff requested that the fund take immediate steps: (1) to advise shareholders of its telephone difficulties through a letter to shareholders and additional disclosure in its prospectus; (2) to provide additional facilities to effect redemptions; and (3) to advise shareholders of the necessity to identify properly all monies forwarded to the fund.

In the case of another money market fund, rapid growth and the high volume of transactions caused its transfer agent to be unable to process shareholder orders accurately. This resulted in an unreconciled error between the value of the outstanding shares of the fund and its assets (i.e., the fund issued too many shares to certain shareholders). Auditors were hired at the expense of the fund's investment adviser to locate and to rectify the discrepancies, and the fund determined to internalize its shareholder accounting services in order to prevent similar problems in the future. The investment adviser of the fund also agreed to pay the fund approximately $163,000 to reimburse it for the losses it incurred.

B. Valuation Methods and Investment Policies

The inspections also revealed that several money market funds were valuing portfolio securities in a manner believed by the inspection staff to be inappropriate. Two such companies were utilizing the amortized cost method of valuation to value non-negotiable certificates of deposit, without exemptive orders and without compliance with the carefully prescribed conditions utilized by other money market funds using such valuation method pursuant to Commission orders. The staff of the Division was particularly concerned with the use of amortized cost valuation in these situations because the certificates of deposit were non-negotiable and, therefore, if the funds had to dispose of any certificates prior to

maturity, they could do so only by redeeming the certificates with the issuing bank at a significant penalty in the rate of interest receivable. Thus, the accrued interest that was declared daily as dividends by these funds represented interest that might not ever have been earned by the funds. In addition, it appeared to the inspection staff that these companies might be violating their fundamental policies which restrict their purchase of securities that are not freely marketable. Finally, the non-negotiable certificates of deposit amounted to more than 50% of the assets of the funds.

To correct these deficiencies, the funds, to the extent possible, converted their certificates of deposit to negotiable certificates of deposit and proceeded to value such certificates by reference to market factors. In each case, the change in valuation method resulted in a reduction in value of certain of the certificates and would have reduced the net assets of the funds. Rather than reduce net asset values per share or significantly reduce dividends in order to account for this loss in value, the investment advisers contributed $420,000 in one case, and $249,383 in the other case, to offset the declines in the values of the underlying portfolio securities. In addition, the funds informed shareholders through letters and amendments to their prospectuses of the inspection staff's views and of the remedial actions taken.

C. Summary

The inspections revealed isolated problems with respect to the operations of some money market funds. The problems have been corrected, and the remedial actions taken by the companies involved have helped to avoid any resulting harm to shareholders. While the nature of the problems could have been serious if certain practices continued unchecked, the inspections were an effective device to secure prompt compliance and avoid possible future adverse effects of a more serious nature upon shareholders. The Commission's regional offices will continue to inspect the operations of money market funds periodically in order to see that no significant regulatory problems are occuring.

V. ENFORCEMENT ACTIONS

In conjunction with an active inspection program, the Commission maintains an active and aggressive enforcement program in the area of money market funds. The Commission has recently settled three cases involving money market funds and has commenced proceedings against others. Through such proceedings the Commission believes that it has stopped harmful or potentially harmful behavior and, where possible, has secured compensation for the fund and it shareholders.

A recently settled case 88/ involved bookkeeping errors pertaining to fund redemptions, which resulted in over payments to some shareholders (shareholder accounts were not correctly debited for partial redemptions). The Commission accepted a settlement of the case which included a censure of the investment adviser and transfer agent, and the institution of new procedures to preclude any future occurrence of the problems. In addition, the investment adviser compensated the fund for losses resulting from the errors.

A second case was instituted against the investment adviser and transfer agent of a fund experiencing problems servicing its shareholder accounts. 89/ Although the fund knew it had old and unreliable computer equipment and that in the past it had experienced a series of problems in handling shareholder accounts, it continued to state in its prospectus, with no disclosure of previous problems, that it could provide a level of service that, given its situation, was unreasonable to expect. In addition the fund continued to accept orders to purchase shares during a period when its computer system was not in operation. The Commission recently settled this case upon agreement that the fund would employ an in house counsel (responsible for advising the board of any steps necessary or advisable to ensure compliance with the federal securities laws), would file certain reports with the Commission, and that the fund would be provided better equipment and service.

A third enforcement proceeding was brought against various defendants involved with a fund that advertised itself as a money market fund but which maintained an average dollar weighted portfolio as high as 825 days. The Commission has settled with two defendants and the commenced proceedings as to the other defendants. 90/

Summary

Although there have been some difficulties involving money market funds, the Division believes that the problems have been relatively isolated. In addition, the Commission has been successful in obtaining rapid correction of the difficulties and, in most cases, full recompense for any injury to the funds involved and

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88/ Government Securities Management Company and Fundlink Information Services, Investment Company Act Release No. 11583 (January 26, 1981), attached hereto as Exhibit Q.

89/ Reserve Management Corporation, et al., Investment Company Act Release No. 11394 (October 10, 1980), attached hereto as Exhibit R.

90/ In the Matter of Paul Buchbaum and S. Jay Levy, Investment Company Act Release No. 11065 (March 4, 1980); First Multifund Advisory Corp., et al., Investment Company Act Release No. 11064 (March 4, 1980), attached hereto as Exhibit S.

their shareholders. While additional difficulties may occur in the future, the Division is confident that the Commision's enforcement program will continue to provide a high level of protection to investors in money market funds.

VI. IMPACT OF RECENT CREDIT CONTROLS ON MONEY MARKET FUNDS

During 1980, money market funds along with other financial institutions were subjected to certain "credit-control" measures [12 CFR 229.11-.15]. As a result of regulations adopted pursuant to the provisions of the Credit Control Act of 1969 [12 U.S.C. 1901 et seq.] by the Board of Governors of the Federal Reserve System ("Board") money market funds were required to maintain special non-interest bearing deposits ("special deposits") with Federal Reserve Banks. Such special deposits were originally equal to 15 percent of the fund's "covered credit," but were later decreased to 7 1/2 percent and by July 28, 1980, were completed eliminated. The implementation of such credit controls raised serious issues regarding the proper reaction by the funds and their boards of directors to such measures and had a significant impact on the operations of many money market funds. 91/

On March 14, 1980, the Division issued a general statement of policy outlining the potential problems and concerns facing money market funds as a result of such regulations. 92/ Such potential problems included how the funds would avoid dilution to the interests of existing shareholders, how funds would treat the special deposits for valuation purposes, whether adjustments in the advisory fee schedules were necessary and what disclosure obligations arose as a result of the regulations. In order to facilitate funds' adjustments to the Board's regulations, the Commission adopted an emergency temporary rule 93/ providing certain exemptions from the provisions of the 1940 Act. The exemptions were designed to minimize disruptions in

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91/ Although money market funds did not experience a large change in their rate of return as a result of the credit control regulation nor did the rate of growth for such funds as a group diminish, for most funds such regulations necessitated additional disclosure to shareholders, plus for many funds, a moritorium on new shareholders and the formation of new funds, all of which involved additional costs.

92/ Investment Company Act Release No. 11088 (March 14, 1980), attached hereto as Exhibit T.

93/ Rule 6c-4(T), Investment Company Act Release No. 11137 (April 22, 1980), attached hereto as Exhibit U.

the operations of investment companies subject to the deposit regulations and other hardships that might otherwise occur while such investment companies were adjusting their operations as a result of the credit control regulations. In reaction to the Board's regulations and the Commission's temporary rule, many money market funds established "clone funds," which were new companies set up to mirror the old company, the only difference being that the new fund was subject to the special deposit while the old one was not.

Similarly, when the special deposit requirements were rescinded, subject money market funds were again faced with a variety of concerns, including what disclosure obligations arose as a result of changes in regulation plus a number of regulatory concerns; especially whether they should continue to maintain the clone fund, and if not, what procedures should be utilized to dissolve the fund. Again the Commission issued a general statement of policy outlining the issues facing such investment companies, 94/ and again took the view that the Commission should facilitate any changes in operations or disclosure that investment companies would need to make in reaction to rescission of the special deposit requirements by the Board. Accordingly, the Commission later issued another emergency temporary rule designed to aid such money market funds in their adjustments. 95/

94/ Investment Company Act Release No. 11263 (July 21, 1980), attached hereto as Exhibit V.

95/ Rule 6c-5(T). Investment Company Act Release No. 11277 (July 25, 1980), attached hereto as Exhibit W.

INDEX TO EXHIBITS

EXHIBIT

A. Investment Company Act Release No. 9786 (May 31, 1977) (Interpretation relating to valuation of short-term debt instruments).

B. First Multifund for Daily Income, Inc. v Securities and Exchange Commission. (Opinion of Judge Flannery of the United States District Court for the District of Columbia) (January 20, 1978).

C. Investment Company Act Release No. 10082 (January 5, 1978) (Notice of holding of public meeting concerning valuation of portfolio securities by money market funds).

D. Investment Company Act Release No. 10201 (April 12, 1978) (Order for consolidated hearing on application for exemptions relating to money market fund pricing and valuation).

E. Investment Company Act Release No. 10451 (October 26, 1979) (Order permitting the use of "penny rounding" pricing, subject to conditions).

F. Investment Company Act Release No. 10824 (August 8, 1979) (Order permitting the use of amortized cost valuation, subject to conditions).

G. Investment Company Act Release Nos. 11586 and 11388 (January 27, 1981 and October 7, 1980) (Orders permitting Institutional Liquid Assets, its adviser and principal underwriter to institute special program).

H. Investment Company Act Release No. 10666 (April 18, 1979) (Statement of policy regarding (1) reverse repurchase agreements (2) firm commitments, and (3) standby commitments).

I. In the Matter of Banker Acceptance Co., et al., Securities Exchange Act Release No. 15974 (June 26, 1979) (Order simultaneously instituting administrative proceeding and accepting offer of settlement).

J. Securities and Exchange Commission v The Fundpack, Inc., et al. (Opinion of Judge Green of the United States District Court for the District of Columbia, August 16, 1979, and order of Judge Green, September 29, 1979).

Exhibits cont.

K. Investment Company Act Release No. 10621 (March 8, 1979) (Withdrawal of Statement of Policy concerning investment company advertising and proposal of Rule 156).

L. Investment Company Act Release No. 10915 (October 26, 1979) (Adoption of Rule 156 concerning false and misleading investment company advertising).

M. Investment Company Act Release No. 10852 (August 31, 1979) (Amendment of Rule 134 and adoption of Rule 434d concerning "tombstone" advertisements, "omitting" prospectuses and investment company advertising).

N. Response of the Division of Investment Management to letter from David Silver, president of the Investment Company Institute (November 16, 1979) ("No action " position relating to yield calculations by money market funds).

O. Investment Company Act Release No. 11379 (September 30, 1980) (Amendment to Rule 434d and Form N-1 concerning standardized yield quotes).

P. Investment Company Act Release No 10453 (October 26, 1978) (Adoption of Rule 17f-4, concerning custody of securities owned by investment companies and deposited in the Federal Reserve/Treasury book-entry system).

Q. <u>Government Securities Management Company and Fundlink Information Services</u>, Investment Company Act Release No. 11583 (January 26, 1981) (Order simultaneously instituting administrative proceeding and imposing remedial sanctions).

R. <u>Reserve Management Corporation, et al.</u>, Investment Company Act Release No. 11394 (October 10, 1980) (Order simultaneously instituting administrative proceedings and imposing remedial sanctions).

S. <u>In the Matter of Paul Buchbaum and S. Jay Levy</u>, Investment Company Act Release No. 11065 (March 4, 1980) (Order simultaneously instituting administrative proceeding and imposing remedial sanctions); <u>First Multifund Advisory Corp. et al.</u>, Investment Company Act Release No. 11064 (March 4, 1980) (Order instituting administrative proceedings).

Exhibits cont.

T. Investment Company Act Release No. 11088 (March 14, 1980) (Statement of policy on effect of credit controls on the operations of certain registered investment companies including money market funds).

U. Rule 6c-4 (T), Investment Company Act Release No. 11137 (April 22, 1980) (Temporary rule providing exemptions to certain money market funds and other persons and companies).

V. Investment Company Act Release No. 11263 (July 21, 1980) (Statement of policy on effect of the termination of credit controls on the operations of certain registered investment companies including money market funds).

W. Rule 6c-5 (T), Investment Company Act Release No. 11277 (July 25, 1980) (Temporary rule providing exemptions to certain money market funds).

cases, it appears that if a shareholder were to redeem his shares after the accrual of tax-exempt income which has not yet been the subject of a dividend declaration, that portion of his redemption proceeds which represents such accrued tax-exempt income will be treated as part of the amount realized for purposes of capital gains computations. This amount may, therefore, be taxed at long- or short-term capital gains rates although it would have been tax exempt had the fund declared it as dividends prior to the redemption. The possibility of such a tax consequence should be disclosed. Furthermore, the dates on which dividends will be declared should be disclosed so shareholders know when a redemption can be effected with the least possible adverse tax consequences. Moreover, the Division believes that Section 36 of the Act may require that directors and managements of such funds consider the dates of redemptions under any automatic withdrawal programs which the fund may have when setting dividend declaration dates in order to maximize, consistent with the tax-exempt income objective of the fund, the amount of income or gain which is tax exempt for shareholders under these programs.

Disclosure Relating to Quality Ratings

Most, if not all, tax-exempt bond funds have as one of their investment policies a policy limiting purchases of bonds to ones which have been given a published quality rating by one of the rating services. Most funds having such a policy currently include in their prospectuses an appendix which describes the criterion for each of the various permissible ratings of the bonds in which it may invest. The Division encourages the continuation of this practice.

Funds which have made ratings a part of their investment policy apparently have determined that ratings are meaningful to investors and that a minimum rating policy is highly desirable. However, the significance of this policy is largely diluted unless information is provided as to the distribution of the portfolio among the various ratings. Therefore, tax-exempt bond funds which make ratings a part of their investment policy should provide information in the prospectus as to the distribution of portfolio securities among the various permissible ratings. The average percentage of assets invested in bonds of each rating over the fund's last fiscal year should be disclosed in the prospectus where rating policies are discussed. In addition, issuers may wish to include bond rating information in their portfolio schedules as is done by many issuers currently.

Names of Tax-exempt Funds

Section 35(d) of the Act in essence prohibits any fund from using a name which implies a certain type of investment unless such name accurately describes the fund's investment policies. Most tax-exempt bond funds have names which suggest that their distributions will be exempt from federal income taxation. In the Division's opinion, during periods of normal market conditions the percentage of income and corresponding distributions which is tax-exempt should be very close to 100% for such funds. In addition, any such fund should have either a fundamental policy requiring that during periods of normal market conditions the fund's assets be invested so that at least 80% of the income will be tax-exempt or a fundamental policy requiring that during periods of normal market conditions the fund have at least 80% of its net assets invested in tax-exempt securities.

By the Commission.

George A. Fitzsimmons
Secretary

INVESTMENT COMPANY ACT OF 1940
Rel. No. 9786/May 31, 1977

ACCOUNTING SERIES
Rel. No. 219/May 31, 1977

VALUATION OF DEBT INSTRUMENTS BY MONEY MARKET FUNDS AND CERTAIN OTHER OPEN-END INVESTMENT COMPANIES

AGENCY: Securities and Exchange Commission.

ACTION: Rule Interpretation.

SUMMARY: The Commission has issued an interpretation of a rule adopted under the Investment Company Act of 1940 (the "Act") indicating, generally, that it shall be considered inappropriate under the provisions of the rule for "money market" funds and certain other open-end investment companies to determine the fair value of debt portfolio securities on an amortized cost basis, except in the case of securities with remaining maturities of 60 days or less. There has been considerable confusion and uncertainty as to the appropriate methods to be utilized by "money market" funds in valuing their portfolio securities. This interpretation should help insure that shares of such companies are sold and redeemed at prices reflecting the fair value of the underlying portfolio securities.

EFFECTIVE DATE: Immediately.

FOR FURTHER INFORMATION CONTACT: Kenneth S. Gerstein; Esq., Division of Investment Management. Securities and Exchange Commission, Washington, D. C. 20549 (202-755-0233).

SUPPLEMENTARY INFORMATION: On April 28, 1975, there was published for public comment notice of a position the Commission proposed to take regarding the standardization of procedures utlized by registered investment companies, including "money market" funds, for the valuation of short-term debt instruments in their portfolios. [40 FR 18467].[1] The proposed valuation position would have suggested "marking to market" as the most appropriate method for valuing any short-term debt securities held by registered investment companies and would have expressed the belief that it would be desirable for such companies to discontinue the "amortized cost" method of valuation.[2]

Among the public comments with respect to the proposed position on valuation of short-term debt instruments were those suggesting that: (1) the benefits of "marking to market" valuation were small compared to the attendant costs of such valuation method; (2) many "money market" fund shareholders desire a valuation method that would achieve a constant asset value; and (3) the Commission lacks the authority to preclude the use of amortized cost valuation. Other commentators suggested that only "money market" funds be required to "mark to market."

Nevertheless, after consideration and analysis of the comments received with respect to the proposal, the Commission, for the reasons discussed below, has issued this interpretation setting forth its views as to the appropriateness of certain methods utilized by "money market" funds and certain other registered open-end management investment companies to determine the fair value of debt securities in their portfolios. The interpretation that the Commission has issued differs in some repsects from the proposed position and is discussed in detail below. The Commission expects companies to comply with this interpretation at the earliest possible date consistent with their obligations to avoid disruption of their operations, but in any event not later than November 30, 1977.

The Commission recognizes that, in the absence of the interpretation it has determined today to issue, there has been considerable confusion and uncertainty as to the appropriate methods to be utilized by "money market" funds in valuing their portfolio securities. This interpretation should help remove the uncertainty and further the objectives of enabling investors in such funds to: (1) purchase and redeem their shares at prices appropriately reflecting the current value of fund portfolio securities; (2) be properly credited for any unrealized appreciation or depreciation in such portfolio securities; and (3) be provided with meaningful and comparable information with which to appraise investment returns and the current earning ability of "money market" funds.

Interpretation With Respect to Valuation of Debt Instruments By Money Market Funds and Certain Other Open-End Investment Companies.

The Commission is aware that many investment companies, including some "money market" funds, value short-term debt instruments in their portfolios on an amortized cost basis. Under this method of valuation, investment companies initially value such instruments at their cost on the date of purchase and, if the instrument was purchased at a discount, thereafter assume a constant proportional increase in value until maturity.[3] However, during the period a debt security is held, changes in the market rate of interest and other factors may affect the price at which that security could be sold. As a general principle, the longer the remaining maturity of an outstanding debt security, the more that price will be affected by such interest rate changes.

The Commission is concerned that the use of the amortized cost method is valuing portfolio securities of registered investment companies may result in overvaluation or undervaluation of the portfolios of such companies, relative to the value of the portfolios determined with reference to current market factors.

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[1] Investment Company Act of 1940 Release No. 8757, April 15, 1975.

[2] Id. The release also indicated the Commission's tentative view that money market funds might be permitted to portray return by means of a quotation such as "yeild to average life." In Investment Company Act Release No. 8816 (June 12, 1975) [40 FR 27492] notice was given of proposed guidelines with repsect to standardizing money market fund yield quotations. Such guidelines would have permitted the use of "yield to average life" quotations. The Commission is still considering these matters.

[3] In simplified terms, for instruments purchased at a discount, the difference between the cost of such an instrument at purchase and its maturity value is divided by the number of days to maturity and that amount is accrued daily as an increase in the value of the instrument each day. More precisely, amortized cost valuation may be described as cost, adjusted for amortization of premium, or for accretion of discount.

In the case of registered open-end management investment companies ("mutual funds" or "funds"), this would mean investors purchasing or redeeming shares could pay or receive more or less than the actual value of their proportionate shares of the funds' current net assets. The effect of such sales or redemptions may therefore result in inappropriate dilution of the assets and returns of existing shareholders.[4]

Although inappropriate valuation of securities could cause these effects in various types of funds, the position take herein is addressed specifically to the case of: (1) "money market" funds, and (2) other open-end investment companies that hold a significant amount of debt securities, such that the use of the amortized cost method is valuing any portion or type of these debt securities could have a material impact on such funds' net asset values per share. Generally, the Commission would consider the use of a particular valuation method to have a material impact if the use of that method, as opposed to another method, might cause a change of at least one cent in a net asset value per share of $10.00.[5] The interpretation explained below will be applicable to both "money market" funds and these other open-end investment companies.[6]

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[4]For example, redemptions of shares in a fund which has overvalued its portfolio or sales of shares in a fund which has undervalued its portfolio could result in the dilution of the assets and returns of other investors in the fund. The extent of such dilutive effects would be dependent upon several factors, including the extent of the overvaluation or undervaluation, and the proportion of fund shares sold or redeemed at such times.

[5]Although one cent differences in net asset values per share of $10.00 might appear to be insignificant, the effects of such differences can be material to the decisions of investors when translated into differences in rates of return. Moreover, the inequitable effects of amortized cost valuation can occur in the case of any open-end investment company where a significant proportion of a company's portfolio consists of debt securities valued at amortized cost. The extent of such inequitable effects will, of course, depend upon changes in interest rates and the level of a company's sales and redemptions of shares.

[6]See, generally, Accounting Series Release No. 118 (December 23, 1970) [35 FR 19986], "Accounting for Investment Securities by Registered Investment Companies," and Investment Company Act of 1940 Release No. 7221 (June 29, 1972) [37 FR 12790], "Guidelines for the Preparation of Form N-8B-1, "as they relate to the valuation of portfolio securities by open-end investment companies.

Generally, "money market" funds are open-end investment companies which invest primarily in short-term debt instruments. They provide a vehicle to permit investors to take advantage of what at times may be the higher short-term interest rates earned on large investments. Through a pooling of money these funds enable the purchase of larger denomination instruments than could normally be bought by the individual small investor. These funds have also attracted investments from corporation, bank trust departments, and other institutional investors. Another characteristic of money market funds is the short-term investment perspective of many shareholders. Although the portfolio composition of "money market" funds is variable both in terms of the types of securities purchased and their maturities, the portfolios of such funds typically include U.S. government and government agency issues, certificates of deposit, banker's acceptances, and commercial paper.

Section 22(c) [15 U.S.C. 80a-22(c)] of the Act [15 U.S.C. 80a-1 et seq.], by reference to Section 22(a) [15 U.S.C. 80a-22(a)] of the Act, authorizes the Commission to adopt rules prescribing, inter alia, methods for computing the minimum purchase price and maximum redemption price of redeemable securities issued by a registered investment company:

* * * for the purpose of eliminating or reducing so far as reasonably practicable any dilution of the value of other outstanding securities of such company or any other result of . . . purchase, redemption, or sale which is unfair to holders of such other outstanding securities . . . .

Section 2(a) (41) [15 U.S.C. 80a-2(a) (41)] of the Act defines "value", as here relevant, to mean:

(B) . . . (i) with respect to securities for which market quotations are readily available, the market value of such securities; and (ii) with respect to other securities and assets, fair value as determined in good faith by the [registered investment company's] board of directors. . . .

Rule 2a-4 [17 C F R 270.2a-4] promulgated under the Act provides, in part, that the "current net asset value" of a redeemable security issued by a registered investment company used in computing its price, for the purposes of distribution and redemption, means:

* * * an amount which reflects calculations. . . made substantially in accordance with the following, with estimates used where necessary or appropriate:

(1) Portfolio securities with respect to which market quotations are readily available shall be valued at current market value, and other securities. . . shall be

valued at fair value as determined in good faith by the board of directors. . . .

Now that both the Commission and the money market fund industry have had the benefit of experience with this relatively new investment product, and to help insure that shares of such funds are sold and redeemed at prices reflecting the current market or fair value of such funds' portfolio securities, the Commission has concluded that is shall prospectively consider it inconsistent with the provisions of Rule 2a-4 for a money market fund to determine the fair value of debt securities which mature at a date more than 60 days subsequent to the valuation date on an amortized cost basis.

Although debt securities with remaining maturities in excess of 60 days should not be valued at amortized cost, the Commission will not object if the board of directors of a money market fund, in good faith, determines that the fair value of debt securities originally purchased with remaining maturities of 60 days or less shall be their amortized cost value, unless the particular circumstances dictate otherwise.[7] Nor will the Commission object if, under similar circumstances, the fair value of debt securities originally purchased with maturities of in excess of 60 days, but which currently have maturities of 60 days or less, is determined by using amortized cost valuation for the 60 days prior to maturity, such amortization being based upon the market or fair value of the securities on the 61st day prior to maturity.[8]

The Commission believes that money market funds and those other companies to which this interpretation is applicable should value debt securities with greater than 60 days remaining to maturity based upon current market quotations if readily available or, if such quotations are not readily available, in such a manner as to take into account any unrealized appreciation or depreciation due to changes in interest rates and other factors which would influence the current fair values of such securities.[9] These methods are sometimes referred to as "marking to market." In determining "fair value" by reference to current interest rates and other factors, the board of directors of a money market fund may, of course, utilize whatever method it determines in good faith to be most appropriate.[10] The method utilized could be based in part, for example, upon quotations by dealers or issuers for securities of similar type, quality and maturity.

Except in the circumstances delineated above, the Commission believes that, in view of the experience which has now been gained with respect to the characteristics of money market funds, the use of the amortized cost method of valuation by a money market fund cannot in the future represent a "good faith" effort to determine the "fair value" of portfolio securities for purposes of Rule 2a-4; such valuation fails to consider the impact of market factors subsequent to the date a debt security is purchased on the value of such security. Moreover, the probability that amortized cost valuation will not approximate "fair value" is progressively greater for securities of increasingly longer maturities. The Commission believes that the use of amortized cost valuation by money market funds in valuing securities with remaining maturities in excess of 60 days is not an appropriate estimate of market value or "fair value" and further that, because alternative valuation procedures which consider market factors are available, use of amortized cost valuation under such circumstances as an estimate is not necessary. This standard should help insure that fund shares are sold

[7]The fair value of securities with remaining maturities of 60 days or less may not always be accurately reflected through the use of amortized cost valuation, due to an impairment of the creditworthiness of an issuer, or other factors. In such situations, it would appear to be incumbent upon the directors of a fund to recognize such factors and take them into account in determining "fair value."

[8]A fund also may use amortized cost valuation for a period less than 60 days prior to maturity, in which case the principles indicated above would also be applicable.

[9]In Accounting Series Release No. 118, note 6, supra, the Commission stated that:

As a general principle, the current 'fair value' of an issue of securities being valued by the Board of Directors would appear to be the amount which the owner might reasonably expect to receive for them upon their current sale.

In that release, the Commission notes various factors that might be considered in arriving at "fair value", which factors included:

yield to maturity with respect to debt issues . . . an evaluation of the forces which influence the market in which these securities are purchased and sold. . . [and the] price and extent of public trading in similar securities of the issuer or comparable companies, and other relevant matters.

[10]*See* note 6 supra.

and redeemed at prices reflecting the appropriate proportionate share of funds' current net assets, and minimize the potential for dilution of the assets and returns of existing shareholders.

The Commission is also of the view that money market fund shareholders should be accurately credited with the effects of any unrealized appreciation or depreciation that may occur when the value of a fund's portfolio fluctuates. If such effects are not reflected in either a fund's net asset value or its distributions to shareholders, as a practical matter the result would be a situation analogous to that which would exist if amortized cost valuation were used, and similar dilutive effects could occur. Such may be the case, for example, where a money market fund "marks to market," but declares a daily dividend of accrued interest income and reflects any remaining unrealized appreciation or depreciation in a "floating" net asset value of $1.00 nominal value per share, rounded to the nearest cent. Under these circumstances, unrealized capital changes, which could materially affect the value of such fund's portfolio, would ordinarily not be of sufficient magnitude to cause the net asset value to change by one cent. The effects of unrealized appreciation and depreciation, in the case of a fund with a "floating" $1.00 net asset value per share, would generally appear in the third and fourth decimal places, and when rounded to the third decimal place (i.e., tenths of one cent) would still not have a one cent impact on the net asset value. Moreover, if such a one cent change should occur, dilution may also result, since a relatively small change in net asset value would cause a larger change in the computed net asset value per share due to rounding. For example, if in the type of fund described above the net asset value was calculated accurately to three decimal places, were a change in net asset value from $1.004 to $1.006 to occur, such change of $.002 would cause the net asset value, when rounded to the nearest cent, to change by one full cent.

To alleviate these results and insure that shareholders are more properly credited for capital appreciation or depreciation, the Commission believes that any money market fund which reflects capital changes in its net asset value per share should calculate, and utilize for purposes of sales and redemptions, a current net asset value per share with an accuracy of one-tenth of one percent (equivalent to the nearest one cent on a net asset value of $10.00).[11] Any less precise calculation by such a fund might have the effect of masking the impact of changing values of portfolio securities and therefore might not "reflect" the fund's calculations pertaining to its portfolio valuation as required by Rule 2a-4.[12]

Boards of directors of money market funds and those other funds referred to above should consider and re-evaluate current fund pricing practices in light of the positions expressed herein. In this regard, the Commission recognizes that such consideration may result in decisions by some funds to make various modification of their valuation and distribution practices. To avoid any sudden changes in net asset values some funds might wish to effect a gradual transition to new valuation methods. Moreover, some time may be necessary to take the action necessary to adopt new dividend policies or other measures designed to implement the views expressed herein. Therefore, to allow adequate time for planning and effecting orderly transitions, the Commission, as noted above, expects companies to comply with this interpretation by no later than November 30, 1977.

By the Commission.

George A. Fitzsimmons
Secretary

May 31, 1977

INVESTMENT COMPANY ACT OF 1940
Rel. No. 9787/June 2, 1977

SEE

SECURITIES ACT OF 1933
Rel. No. 5830/June 2, 1977

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[11] Such calculation is applicable only with respect to those money market funds which do not include in their distributions to shareholders all capital changes. If such a fund had a net asset value of $10.00 per share, it would be appropriate to calculate its current net asset value accurately to one tenth of a cent, rounded to the nearest one cent. If such a fund had a net asset value per share of $1.00 it would be appropriate to calculate its current net asset value accurately to the nearest one hundredth of one cent, rounded o the nearest one tenth of one cent.

[12] *See* note 5, *supra*.

injunction will restrain Medicorp from disseminating materially false or misleading statements as to either of those offers as well.

This memorandum sets forth the court's findings of fact and conclusions of law as required by Rule 52(a) of the Federal Rules of Civil Procedure.

Medicorp's motion for injunctive relief is denied in all respects. Humana's motion is granted to the extent of enjoining Medicorp, its directors, officers, agents and employees from disseminating materially false and misleading statements as to: 1) Humana's proposed offer as set forth in its letter to Alan Miller, President of Medicorp, dated September 27, 1977 and its Registration Statement declared effective December 22, 1977, and 2) the offer of Trans World Airlines, Inc. and Hilton International Co., as set forth in their offering circular of December 21, 1977, and 3) Humana's revised offer as set forth in Amendment No. 17 to its Schedule 14D-1 and the supplement therein filed with the Securities & Exchange Commission December 30, 1977, and is otherwise denied.

[¶ 96,287] First Multifund for Daily Income, Inc. v. Securities and Exchange Commission, et al.

United States District Court, District of Columbia. Civil Action No. 77-1845. January 20, 1978. Opinion in full text.

Investment Company Act—Valuation of Securities—Good Faith—Challenge to SEC Interpretation—Standing—Ripeness.—Although an investment company had standing to sue the Securities and Exchange Commission based upon the SEC's interpretation, as expressed in a release, of what constitutes "good faith" by a board of directors in determining the value of open-end investment company or mutual fund securities, this case was not yet ripe for judicial consideration. Since the Commission stated that it expected compliance with the terms of the interpretation no later than November 30, 1977, the release was more than merely advisory. The practical effect of the release was to compel compliance by a certain date unless an exemption was granted. Thus, plaintiff had standing. However, there was an inherent weakness in this matter's fitness for judicial review by the fact that it involved a preenforcement situation. The investment company still had open to it a process by which it could seek an exemption from the application of the rule. In addition, plaintiff failed to show that any real hardship would result from the withholding of judicial action at this time.

See ¶ 47,250, "Investment Companies—Definitions" division, Volume 4; and ¶ 72,241, "Accounting Releases" division, Volume 5.

Carl L. Shipley, District of Columbia, for plaintiff.

Elisse B. Walter, District of Columbia, for defendant.

FLANNERY, District Judge: This matter comes before the court on plaintiff's motion for summary judgment and defendant's cross-motion for dismissal, or in the alternative, for summary judgment. The facts in this case are not in dispute. The Securities and Exchange Commission (S.E.C.) is empowered by the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1, *et seq.*, to regulate open-end investment companies and mutual funds. Such companies and funds are required to redeem their securities on demand, 15 U.S.C. § 80a-22(e), at a price based on the value of the entire security portfolio owned by the fund at the time of the redemption or sale of the shares in the fund. 15 U.S.C. § 80a-2(a)(32). Congress stated that registered securities associations had the authority under the Act to promulgate rules governing the minimum purchase price and maximum redemption price for redeemable shares in such open-end investment companies or mutual funds,

> for the purpose of eliminating or reducing, so far as reasonably practicable, any dilution of the value of other outstanding securities of such company or any other result of . . . purchase, redemption, or sale which is unfair to holders of such other outstanding securities. . . .

15 U.S.C. § 80a-22(a). At the same time, Congress allowed the S.E.C. to promulgate rules and regulations to accomplish the same purposes, and indicated that if an S.E.C. rule conflicted with that of a securities association, the S.E.C. rule would prevail. 15 U.S.C. § 80a-22(c). In making such a determination of value of open-end investment company or mutual fund securities, 15 U.S.C. § 80a-2(a)(41) provides:

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> "Value", with respect to assets of registered investment companies ... means—
>
> (B) ... (i) with respect to securities for which market quotations are readily available, the market value of such securities; and (ii) with respect to other securities and assets, fair value as determined in good faith by the board of directors;
>
> in each case as of such time or times as determined pursuant to this subchapter, and the rules and regulations issued by the Commission hereunder.

The S.E.C. has exercised its rulemaking power in this area by issuing Rule 2a-4 which provides that the value of such securities not readily subject to a market price quotation shall be "determined in good faith by the board of directors." 17 C.F.R. § 270.2a-4 (1977).

This suit involves a dispute regarding the S.E.C.'s Investment Company Act of 1940 Release No. 9786 (May 31, 1977) (hereinafter the Release). In issuing this Release, the S.E.C. purports to interpret the term "good faith" as used in 15 U.S.C. § 80a-2(a)(41) and Rule 2a-4. The Release states that, in the view of the S.E.C., the board of directors of an open-end investment company or mutual fund determines the fair value of securities in good faith only when such value is determined

> in such a manner as to take into account any unrealized appreciation or depreciation due to changes in interest rates and other factors which would influence the current fair values of such securities.

Although this interpretation was issued on May 31, 1977, the S.E.C. allowed for a six month interim period for transition to this new valuation method, indicating that the Commission "expects companies to comply with this interpretation by no later than November 30, 1977."

Plaintiff is an open-end investment company subject to the Investment Company Act of 1940 and the rules and regulations promulgated pursuant thereto. Plaintiff contends that the Release is arbitrary, capricious, and contrary to the terms of the Investment Company Act of 1940 and the United States Constitution. Defendant disagrees with plaintiff's assessment of the merits, and also raises two procedural barriers to this court's consideration of this case. Defendant contends first that plaintiff lacks standing to bring this suit, and second that this matter is not ripe for adjudication. For reasons more fully stated below, this court holds that, although plaintiff does have standing to sue, this case is not yet ripe for judicial consideration and should, therefore, be dismissed.

With regard to the assertion that plaintiff lacks standing, defendant makes two points. First, defendant argues that the Release is merely an advisory expression of its policy which adjudicates no rights and which, therefore, does not harm the plaintiff. Second, defendant contends that plaintiff has alleged no real injury resulting from the issuance of the release.

Examination of the terms of the Release and the history of its promulgation indicate that it is not merely an advisory expression of policy. In the Release, the S.E.C. states that it expected compliance with the terms of the interpretation no later than November 30, 1977. If the Release were merely advisory and compliance with it voluntary, compliance by a certain deadline could not be expected. Furthermore, the S.E.C. has indicated that the Release was a result of several years of study of the unprecedented growth of mutual funds and open-end investment companies, which study led to the conclusion that more stringent guidelines were necessary to accomplish Congress' regulatory purpose in this area. The Release, when viewed against this background, would seem to be more mandatory than advisory. This court is not bound by the agency's characterization of its Release. *New York Stock Exchange v. Bloom*, 562 F. 2d 736, 740 (D.C. Cir. 1977); *Independent Broker-Dealers' Trade Ass'n v. S.E.C.*, 442 F. 2d 132, 137-39 (D.C. Cir. 1971). A court should not lightly find that an agency release is nonreviewable, especially when the sole basis for such a finding would be the agency's own description of its release. Rather, the court must look to the practical effect of the release in determining whether it is merely advisory or whether it does determine the rights of the parties. *Independent Broker-Dealers' Trade Ass'n v. S.E.C., supra*, 442 F. 2d at 139. The practical effect of the release in this case is to compel compliance by a certain date unless an exemption is granted. As such, plaintiff cannot be deprived of standing simply on this basis.

Plaintiff also shows injury sufficient to support a finding of standing. It is true that many of the injuries asserted by plaintiff are speculative, since most involve the possibility of civil suits, as yet unfiled,

against plaintiff for changing the valuation method of its securities. However, it is clear that the Release is designed to act directly upon plaintiff's portfolio, most likely causing it to be revalued downward. This would amount to a loss to the plaintiff. Although this might only be a loss on paper, and even though the loss may be slight, it is sufficient to confer plaintiff with standing.

Although the plaintiff has standing to sue, this is no guarantee that this suit is ripe for judicial action. Plaintiff seeks pre-enforcement review of the Release. The determination of ripeness in such an administrative setting is governed by the Supreme Court's decision in *Abbott Laboratories, Inc. v. Bloom*, 87 S. Ct. 1507 (1967), where the Court said that the ripeness doctrine in the administrative review setting was designed primarily

> to prevent the courts, through the avoidance of premature adjudication, from entangling themselves in abstract disagreements over administrative policies, and also to protect the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by challenging parties.

Id. at 1515. The Court in *Abbott* enunciated a two part test to effectuate this purpose. First, the court must decide if the issues presented are fit for judicial decision. Second, the court must determine if the parties will suffer hardship if judicial action is withheld. *Id.* The stronger the showing on one of these points, the less is the required showing on the other. *New York Stock Exchange v. Bloom, supra*, 562 F. 2d at 741.

Since this case involves a preenforcement situation, there is an inherent weakness in its fitness for judicial review. While it is true that the S.E.C. has stated that it expected compliance with the Release no later than November 30, 1977, the S.E.C. has also indicated that the method and timing of enforcement of the Release has not yet been decided. Furthermore, and perhaps more importantly for the purposes of this case, plaintiff still has open to it a process by which it may seek an exemption from the application of the rule. 15 U.S.C. § 80a-6(c) provides that the S.E.C. may exempt plaintiff from the application of the Release

> if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter.

Plaintiff has informed the court that its portfolio consists totally of deposit certificates from large New York banks, and that such certificates would not be properly valued if plaintiff were to follow the method prescribed by the Release. However, this argument seems to be precisely the type that should be made to the S.E.C. in an application for a section 80a-6(c) exemption. Although plaintiff protests that applying for such an exemption is a tacit acknowledgement of the validity of the Release, the fact of the matter is that the S.E.C. has already granted several exemptions from the terms of the Release pending the outcome of litigation. Since plaintiff has not attempted to secure such an exemption, the issues presented in this suit do not seem to be fit for judicial decision.

In addition, plaintiff fails to show that any real hardship will result from the withholding of judicial action at this time. It is difficult to see how plaintiff can be subjected to civil liability for complying in good faith with a directive from the S.E.C. Further, although plaintiff's standing is predicated upon the fact that the Release will force a revaluation of plaintiff's portfolio, the precise effect and extent of that revaluation is unclear. Although there is the distinct possibility that the new method of computing the redemption price will result in a diminution in the value of plaintiff's portfolio, plaintiff's portfolio is just as likely to increase in value since such changes depend on the conditions in the money market at that time. Tying the values of plaintiff's securities more closely to the market does not seem to be the type of hardship necessary to establish ripeness. Although the Release is more than an informal expression of opinion, the fact that it does not carry with it dire alternatives caused by compliance or noncompliance, and the availability of a statutory exemption process indicate that plaintiff is not presented with a "Hobson's choice" such as would warrant judicial action. *See New York Stock Exchange v. Bloom, supra.* Since plaintiff will not be unduly prejudiced by awaiting judicial action at another time, this matter is not ripe for adjudication and this court should not reach the merits of the parties' contentions.

For these reasons, and upon consideration of plaintiff's motion for summary judg-

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ment, defendant's motion to dismiss or in the alternative for summary judgment, the memoranda submitted in support thereof and in opposition thereto, oral argument thereon, and the entire record now before the court, it is, by this court, this 20th day of January, 1978,

ORDERED that plaintiff's motion for summary judgment be, and the same hereby is, denied; and it is further

ORDERED that defendant's motion to dismiss or in the alternative for summary judgment be, and the same hereby is, granted; and it is further

ORDERED that this case be, and hereby is, dismissed for lack of ripeness.

[¶ 96,288] Bache Halsey Stuart, Inc. v. Affiliated Mortgage Investments, Inc., et al.

United States District Court, Northern District of Georgia, Atlanta Division. C76-272A. December 20, 1977. Opinion in full text.

Securities Act—Exemptions—Sales—GNMA Certificates—Future Delivery.—Contracts for the purchase of mortgage-backed certificates guaranteed by the Government National Mortgage Association for delivery at a stated time in the future are not securities required to be registered under the Securities Act. The GNMA certificates are specifically exempted from registration as securities guaranteed by the United States. The delayed delivery aspect of the transactions does not constitute a separate contract. The sales involved in this case were solely sales of exempt GNMA certificates.

See ¶ 1101, "Securities Act—Definitions" division; and ¶ 2021, "Securities Act—Exemptions" division, Volume 1.

MOYE, District Judge: This is an action for violation of the Securities Exchange Act of 1934, 15 U. S. C. § 78j; and Rule 10b-5 promulgated thereunder. The case is before the Court for the second time on the plaintiff's motion for judgment on the pleadings as to Count IV of the defendant's counterclaim.

The issue presented for resolution at this time is whether or not certain contracts entered into by the parties for the purchase of mortgage-backed certificates guaranteed by the Government National Mortgage Association (GNMA certificates) for delivery at a stated time in the future were securities required to be registered by section 5 of the Securities Act of 1933, 15 U. S. C. § 77e. When the issue was first presented, the Court requested briefs from the parties and from the Securities and Exchange Commission (SEC) concerning the issue at hand. The GNMA Mortgage-Backed Securities Dealers Association (Dealers Association) requested and was granted leave to file a brief amicus curiae on the issue as well. The Court now has before it the briefs of the parties and the Dealers Association. The SEC has declined to file an amicus brief.

The instruments in question are certificates, each representing a share in a pool of mortgages insured by various federal agencies, payable at a fixed rate of interest. The certificates are transferable, and those instruments bearing the same interest rate are fully fungible. The certificates are issued in a minimum denomination of $25,000 and are sold in amounts of not less than $1 million. The certificates sold in the transactions at issue are modified pass-through securities issued in pools of single family home mortgages, meaning that the issuer is obliged to transmit a pro rata share of monthly interest and principal payments to the security holder, whether or not such payments have been made. The interest and principal payments are guaranteed by GNMA and are backed by the full faith and credit of the United States government. The securities are issued by mortgage bankers who assemble the pools of mortgages for sale to broker-dealers such as the plaintiff, banks, savings and loan associations, credit unions, and other thrift institutions. Purchase by an individual investor is rare.

The usual sale of a modified pass-through GNMA security provides for delivery of the certificate and payment on a specified date some 30 to 180 days after the negotiation of the sale. The purchaser may elect to take delivery of the security and make

VESTMENT COMPANY ACT OF 1940
lease No. 10081/January 5, 1978

the Matter of

ORPUS CHRISTI CAPITAL CORPORATION
I Pine Street
ew York, New York 10005

12-4201)

RDER PURSUANT TO SECTION 6(c) OF THE ACT RANTING EXEMPTION FROM ALL PROVISIONS OF HE ACT

orpus Christi Capital Corporation ("Applicant") filed application on October 4, 1977, and amendments ereto on November 17, 1977 and December 1, 1977, r an order of the Commission pursuant to Section c) of the Investment Company Act of 1940 ("Act"), empting Applicant from all provisions of the Act, ibject to certain conditions. Applicant sought relief connection with its proposed sale of secured notes finance the construction of an ethylene producing ant near Corpus Christi, Texas.

n December 7, 1977, a notice was issued (Investent Company Act Release No. 10045) of the filing of e application. The notice gave interested persons an pportunity to request a hearing and stated that an der disposing of the application would be issued as course unless a hearing should be ordered. No quest for a hearing has been filed, and the ommission has not ordered a hearing.

ne matter having been considered, it is found, on the isis of the information contained in the application, iat the granting of the exemption is appropriate in ie public interest and consistent with the protection investors and the purposes fairly intended by the olicy and provisions of the Act. Accordingly,

IS ORDERED, pursuant to Section 6(c) of the Act, iat the application for an order exempting Corpus hristi Capital Corporation from all provisions of the ct, subject to the conditions stated in the application and summarized in the notice, be, and hereby is, anted, effective forthwith.

The Commission, by the Division of Investment ...ment, pursuant to delegated authority.

George A. Fitzsimmons
Secretary

DOCKET

INVESTMENT COMPANY ACT OF 1940
Release No. 10082/January 5, 1978

Public Meeting Concerning Valuation of Portfolio Securities by Money Market Funds

The Commission announces that on January 26, 1978, at 2:00 p.m. in Room 825 at the Commission's offices, 500 North Capitol Street, Washington, D.C. 20549, it will hold a public meeting at which interested persons may express their views concerning the valuation of portfolio securities by money market funds.

On May 31, 1977, the Commission issued an interpretative release (Investment Company Act Release No. 9786) ("Release No. 9786") [42 FR 28999, June 7, 1977], expressing, generally, the view that money market funds should determine the fair value of short-term debt securities for which market quotations are not readily available by reference to current market factors. The release indicated that use of the amortized cost method of valuation did not ordinarily take such factors properly into account, and therefore could be inconsistent with the provisions of Rule 2a-4 [17 CFR 270.2a-4] under the Investment Company Act of 1940 (the "Act") [15 U.S.C. 80a-1 et seq.].

Subsequent to the issuance of Release No. 9786, nine applications were filed on behalf of money market funds seeking exemptions from appropriate provisons of the Act which, if granted, would permit the use of amortized cost valuation under specified circumstances and conditions.[1] In addition, a number of

[1]Notices of the filing of seven such applications have been published in the Federal Register giving interested persons an opportunity to request that hearings be held on them. Certain communications have been received by the Commission which raise questions as to whether hearings should be ordered on these applications. Pending resolution of these matters, the Commission issued an order granting the exemptions requested in the seven applications on a temporary basis subject to certain specified conditions (Investment Company Act Release No. 10027, November 28, 1977).

persons have raised questions with regard to the interpretation set forth in Release No. 9786. Although the Commission continues to believe its position on this matter is correct, in view of the aforementioned developments, the Commission believes that it would be appropriate at this time to schedule a public meeting to enable interested persons to present their views orally on the issue of money market fund portfolio valuation to the Commission. The meeting will afford persons affected by the interpretation announced in Release No. 9786 an additional opportunity to bring their views directly to the Commission's attention.

Members of the public are invited to attend the meeting. All persons wishing to speak at the meeting should submit a request in writing by January 20, 1978, to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, indicating the nature of their interest in the matter, a summary of the views they propose to present, and an estimate of how much time they would need to present their views. Written submissions on the subject will also be considered.

To obtain further information, contact Kenneth S. Gerstein at (202) 755-0233 or Dianne E. O'Donnell at (202) 755-0225.

By the Commission.

George A. Fitzsimmons
Secretary

INVESTMENT COMPANY ACT OF 1940
Release No. 10083/January 5, 1978

In the Matter of

INTERNATIONAL INVESTORS INCORPORATED

and

I.I.I. SECURITIES CORPORATION
122 East 42nd Street
New York, New York

(812-4249)

NOTICE OF FILING OF AN APPLICATION FOR AN ORDER PURSUANT TO SECTION 6(c) OF THE ACT FOR AN ORDER EXEMPTING A PROPOSED EXCHANGE OF SHARES FROM THE PROVISIONS OF SECTION 22(d) OF THAT ACT.

NOTICE IS HEREBY GIVEN that International Investors Incorporated ("International"), registered under the Investment Company Act of 1940 ("Act") as an open-end, diversified, management investment company, and I.I.I. Securities Corporation, its principal underwriter ("III"), filed an application on December 15, 1977, for an order of the Commission pursuant to Section 6(c) of the Act exempting from the provisions of Section 22(d) of the Act proposed transactions ("Sales") pursuant to which shares of International will be issued at net asset value without a sales charge in exchange for shares of certain gold mining companies ("Securities") held by Mondial Commercial Limited, a Liechtenstein limited company ("Mondial"), through two of their accounts at the Swiss Credit Bank, the Metric Accounting Unit Survival Contract ("MAUSC") subaccount and the Soverign Contracts ("Sovereign") subaccount (collectively, the "Subaccounts"), in which approximately 512 persons have beneficial interests ("Account Holders"). All interested persons are referred to the application on file with the Commission for a statement of the representations made therein, which are summarized below.

International has been informed that Progress Foundation, a Swiss charitable institution, owns all of the stock of Mondial. In November, 1975, the Commission initiated enforcement proceedings in the United States District Court for the District of Columbia (the "District Court") against various individuals and entities, including Progress Foundation and Mondial. The Court appointed a special counsel (the "Special Counsel") on behalf of the Account Holders. Additionally, the Swiss Banking Commission issued a decree (the "Swiss Decree") in June 1976, providing that all assets of the various Mondial subaccounts, including the Subaccounts, be distributed to the investors in a manner to be approved by the Swiss Banking Commission and satisfactory to the Commission.

International has been advised by the Special Counsel that in furtherance of the Swiss Decree, and in connection with settlement of the enforcement proceedings initiated by the Commission, plans calling for the complete distribution of the assets in the Subaccounts were presented to the Swiss Banking Commission and the District Court for approval. The District Court approved such plans by order dated December 6, 1977. The Swiss Banking Commission is expected to consider the plans on January 19, 1978, and the Special Counsel has been advised that the

of, such acquisition, the value of the investment securities then held by Standard (other than securities of such controlled affiliates) equals or exceeds forty percent (40%) of the value of Standard's total assets at such time. This undertaking in no way limits the right of Standard to receive at any time any securities distributed or issued to Standard with reference to any securities then held by it, whether by reason of any stock split, stock dividend, reorganization, merger, conversion or otherwise. Standard states that it will not invest any net earnings from its operating assets in investment securities other than securities of controlled affiliates except that investments may be made in short term securities pending application of such income to pay dividends, to invest in directly owned operating businesses, to acquire securities of present and future controlled operating affiliates or to repay any borrowings incurred for such purposes. It also represents that it has no present intention to issue new securities upon deregistering, except that it would be prepared to do so in connection with the acquisition of operating businesses.

The application states that on May 3, 1977, Standard shareholders voted to cease being an investment company and to seek an order of the Commission terminating its registration under the Act. Moreover, since that vote, Standard asserts that its management has been actively seeking and negotiating for operating business acquisitions.

Section 8(f) of the Act provides, in pertinent part, that whenever the Commission upon application finds that a registered investment company has ceased to be an investment company, it shall so declare by order and upon taking effect of such order, the registration of such company shall cease to be in effect. Standard states that for the reasons stated above, it is entitled to an order pursuant to Section 8(f) declaring that it has ceased to be an investment company.

NOTICE IS FURTHER GIVEN that any interested person may, not later than May 8, 1978, at 5:30 p.m., submit to the Commission in writing a request for a hearing on the matter accompanied by a statement as to the nature of his interest, the reason for such request, and the issues, if any, of fact or law proposed to be controverted, or he may request that he be notified if the Commission shall order a hearing thereon. Any such communication should be addressed: Secretary, Securities and Exchange Commission, Washington, D.C. 20549. A copy of such request shall be served personally or by mail upon Standard at the address stated above. Proof of such service (by affidavit or, in the case of an attorney-at-law, by certificate) shall be filed contemporaneously with the request. As provided by Rule 0-5 of the Rules and Regulations promulgated under the Act, an order disposing of the application will be issued as of course following said date unless the Commission thereafter orders a hearing upon request or upon the Commission's own motion. Persons who request a hearing, or advice as to whether a hearing is ordered, will receive any notices and orders issued in this matter, including the date of the hearing (if ordered) and any postponements thereof.

By the Commission.

George A. Fitzsimmons
Secretary

INVESTMENT COMPANY ACT OF 1940
Release No. 10201/April 12, 1978

In the Matters of

INTERCAPITAL LIQUID ASSET FUND, INC.
130 Liberty Street
New York, New York 10006
(812-4230)

TEMPORARY INVESTMENT FUND, INC.

and

TRUST FOR SHORT-TERM FEDERAL SECURITIES
1730 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(812-4173)

MONEY MARKET MANAGEMENT, INC.

and

TRUST FOR SHORT-TERM U.S. GOVERNMENT SECURITIES
421 Seventh Avenue
Pittsburgh, Pennsylvania 15219
(812-4177)

SCUDDER CASH INVESTMENT TRUST
175 Federal Street
Boston, Massachusetts 02110
(812-4200)

NSTITUTIONAL LIQUID ASSETS, INC.
I700 Sears Tower
:hicago, Illinois 60606
812-4208)

VHITE WELD MONEY MARKET FUND, INC.

ınd

VHITE WELD GOVERNMENT FUND, INC.
00 Federal Street
3oston, Massachusetts 02110
812-4213)

'UND FOR GOVERNMENT INVESTORS, INC.
735 K Street, N.W.
Vashington, D.C. 20006
312-4216)

)AILY INCOME FUND, INC.
:30 Park Avenue
lew York, New York 10017
812-4217)

IREYFUS MONEY MARKET INSTRUMENTS, INC.
67 Fifth Avenue
lew York, New York 10022
312-4229)

nd

'EDERATED MASTER TRUST
21 Seventh Avenue
'ittsburgh, Pennsylvania 15219
312-4236)

IOTICE OF FILING OF APPLICATION FOR ORDER 'URSUANT TO SECTION 6(c) OF THE ACT GRANTING :XEMPTIONS FROM SECTION 2(a)(41) OF THE ACT ,ND RULES 2a-4 AND 22c-1 THEREUNDER.

IOTICE OF AND ORDER FOR HEARING ON ,PPLICATIONS PURSUANT TO SECTION 6(c) OF THE ,CT FOR EXEMPTIONS FROM SECTION 2(a)(41) OF 'HE ACT AND RULES 2a-4 AND 22c-1 THEREUNDER.

NOTICE OF FILING OF APPLICATION

IOTICE IS HEREBY GIVEN that InterCapital Liquid ,sset Fund, Inc. ("InterCapital"), registered under the ıvestment Company Act of 1940 (the "Act") as an 'pen-end, diversified, management investment company, filed an application on November 23, 1977, for an order of the Commission, pursuant to Section 6(c) of the Act, exempting InterCapital from the provisions of Section 2(a)(41) of the Act and Rules 2a-4 and 22c-1 thereunder, to the extent necessary to permit InterCapital to value its assets in the manner set forth in the application, which generally would be the "amortized cost" method of valuation, whether or not market quotations for its portfolio securities are available. All interested persons are referred to the application on file with the Commission for a statement of the representations contained therein, which are summarized below.

InterCapital states that it is a "money market" fund, designed as an investment vehicle for investors with temporary cash balances or cash reserves, and that its investment objectives are high current income, preservation of capital and liquidity. InterCapital also states that Dean Witter InterCapital, Inc., a wholly-owned subsidiary of Dean Witter Organization, Inc., acts as investment adviser to InterCapital.

InterCapital further states that its portfolio may be invested in a variety of money market instruments, including U.S. Government securities, bank obligations, commercial paper and corporate obligations maturing in two years or less. InterCapital represents that, in general, its policy is to hold securities purchased until maturity and, ordinarily, to hold a major portion of its assets in securities that mature in one year or less from the date of purchase.

According to the application, as of November 21, 1977, InterCapital had approximately $26 million in net assets. As of the same date, approximately 61% of its assets were held by individuals, a large majority of whom purchased their shares through brokers, and approximately 39% of its assets were held by religious, charitable or other eleemosynary institutions, municipalities, bank trust departments, individual fiduciaries, corporations, unions and pension funds. InterCapital states that its minimum initial investment is $5,000, and that subsequent investments must be in the amount of at least $100. InterCapital asserts that the maintenance of a constant net asset value through the use of amortized cost valuation is crucial to institutional investors and to brokers representing individual investors, in their use of InterCapital's shares for investment of cash reserves or temporary cash balances. InterCapital also asserts that the maintenance of a constant net asset value through the use of amortized cost valuation is of overriding importance to individual investors. InterCapital states that amortized cost valuation recognizes the existence of imperfect markets for the resale of portfolio securities and the intangible value of the enhanced liquidity offered by a mutual fund on a pool of assets that are not in themselves entirely liquid.

nterCapital further states that, in the opinion of its ndependent directors, valuation of securities on a narking to market basis is only a pretense, in that such valuation calls for a calculation of precise numbers and assumes, contrary to fact, the existence of perfect markets. InterCapital asserts that calculation of valuation pursuant to market valuation can be made only by marking to hypothetical market valuations, since there are no uniform market values at which an existing body of assets could be actually sold or actually reproduced. InterCapital states that during its existence its management has monitored the effects of amortized cost valuation by means of a periodic "mark to market" estimate of value, and it asserts that at no time did such estimate of value vary from amortized cost by an amount as much as ½ cent per share based on a $1.00 per share market price. It further asserts that the amortized cost method of valuation recognizes the fact that its portfolio securities are most often held to maturity and, therefore, interim changes in value of such securities will not be realized. It states that since such changes are, in any event, not precisely measurable, to attempt to record them precisely through market valuation and to reflect them in asset value is fictional and contrary to reasonable expectations. InterCapital asserts that, given the foregoing, and what it considered to be negligible variances between amortized cost valuation and values based on a hypothetical market, its directors determined in good faith that the amortized cost method of valuation of portfolio securities was appropriate.

As here pertinent, Section 2(a)(41) of the Act defines "value" to mean: (1) with respect to securities for which market quotations are readily available, the market value of such securities, and (2) with respect to other securities, fair value as determined in good faith by the board of directors.

Rule 22c-1 adopted under the Act provides, in part, that no registered investment company issuing any redeemable security shall sell, redeem or repurchase any such security except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security. Rule 2a-4 adopted under the Act provides, as here relevant, that the "current net asset value" of a redeemable security issued by a registered investment company used in computing its price for the purposes of distribution and redemption shall be an amount which reflects calculations made substantially in accordance with the provisions of that Rule, with estimates used where necessary or appropriate. Rule 2a-4 further provides that portfolio securities for which market quotations are readily available shall be valued at current market value, and other securities shall be valued at fair value as determined in good faith by the board of directors.

Section 6(c) of the Act provides, in part, that the Commission may, upon application, exempt any person, security, or transaction, or any class or classes or persons, securities, or transactions, from any provision or provisions of the Act or any rule thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

InterCapital has requested an order of the Commission, pursuant to Section 6(c) of the Act, exempting it from the provisions of Section 2(a)(41) of the Act and Rules 2a-4 and 22c-1 thereunder to the extent that the amortized cost method of valuation as employed by InterCapital, whether or not market quotations are available, may be deemed not to comply fully with the requirements of Section 2(a)(41) and Rules 2a-4 and 22c-1.

InterCapital states that its requested exemption is appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act, because the amortized cost method of valuation is a traditional and well-recognized method of valuing short-term money market instruments used by major state and federal agencies and large institutional investors. InterCapital represents that the selection and maintenance of a 180-day or less average maturity for portfolio instruments will protect its shareholders from the unfair treatment they would receive if it were forced to use market valuation for securities which will generally be held to maturity, while at the same time making possible yields which are reflective of the general money market.

InterCapital makes the following representations as a condition to the granting of the exemptive order it seeks:

1. That it will adopt the following investment policies: (a) investments will be made only in instruments having a remaining maturity of one year or less, and (b) its portfolio will be managed so that (i) the average maturity of all instruments in the portfolio (on a dollar-weighted basis) will be 180 days or less, and (ii) adequate liquidity will be maintained to meet anticipated redemptions in the normal course of business and to minimize the possibility that portfolio securities will have to be sold to meet redemption requests.

2. That it will not sell instruments in its portfolio prior to maturity unless such sale or other disposition is

ned necessary to meet redemption requirements, ; a result of a revised credit evaluation of the issuer ther circumstances not presently foreseeable.

That it will limit investments in commercial paper investment grade issues rated A-1 or A-2 by idard and Poor's Corporation or Prime 1 by xdy's Investors Services, Inc., or if not rated, issued ı company having an outstanding debt issue rated :ast AA by Standard & Poor's or Aa by Moody's, and ne extent that it invests in instruments of banks, it limit its investments to those institutions which at date of investment have capital, surplus and livided profits as of the date of their most recently olished financial statements in excess of $1 billion.

That it will describe in its prospectus the policies l practices set forth in its application and the icept and impact of valuation of instruments using amortized cost method as compared to the mark to rket method upon its reported yield and net asset ue.

NOTICE OF AND ORDER FOR HEARINGS, AND IDER JOINING HEARINGS AND CONSOLIDATING IOCEEDINGS.

ı May 31, 1977, the Commission issued an erpretation (Investment Company Act Release No. 86) ("Release") of Section 2(a)(41) of the Act and ile 2a-4 thereunder which, among other things, ated the Commission's views that: (1) it is :onsistent generally with the provisions of Section a)(41) of the Act and Rule 2a-4 thereunder for "money arket" funds to value their assets on an amortized st basis, ignoring market factors, and (2) it is :onsistent with the provisions of Rule 2a-4 for such nds to "round off" calculations of their net asset lues per share to the nearest one cent on a share lue of $1.00.

veral "money market" funds have applied to the mmission, pursuant to Section 6(c) of the Act, for emptive orders, to the extent those orders might be cessary, either to permit them to value their assets an amortized cost basis, or to permit them to lculate their net asset values to the nearest one cent a $1.00 share.

ı October 21, 1977, the Commission issued a notice the filing of such an application by Money Market inagement, Inc., *et al.*, (Investment Company Act lease No. 9967). Subsequently, notices of other ch applications were issued, as follows: (1) mporary Investment Fund, Inc., *et al.*, (Investment mpany Act Release No. 9983, November 1, 1977); (2) udder Cash Investment Trust (Investment Company t Release No. 9992, November 4, 1977); (3) Daily Income Fund, Inc. (Investment Company Act Release No. 9998, November 8, 1977); (4) White Weld Money Market Fund, Inc., *et al.*, (Investment Company Act Release No. 9999, November 8, 1977); (5) Institutional Liquid Assets, Inc. (Investment Company Act Release No. 10000, November 8, 1977); and (6) Fund for Government Investors, Inc. (Investment Company Act Release No. 10007, November 10, 1977). All of the aforementioned applications request exemptions from the provisions of Section 2(a)(41) of the Act and Rules 2a-4 and 22c-1 thereunder to permit the valuation of assets on an amortized cost basis, with the exception of the application of Temporary Investment Fund, Inc., *et al.*, which seeks an exemption from Rule 2a-4 to permit calculation of net asset value per share to the nearest one cent on a share value of $1.00.

The aforementioned notices gave interested persons an opportunity to request a hearing on the respective matters and stated, in each case, that an order disposing of that application would be issued as of course (following the expiration of the various periods specified in the notices) unless the Commission should thereafter order a hearing thereon, either upon request or upon the Commission's own motion. The Dreyfus Corporation and Reserve Management Corporation, registered investment advisers to other money market funds, have filed requests for such hearings. They assert, generally, that amortized cost is an inappropriate valuation method.

Three additional applications requesting exemptive relief similar to that requested in the seven applications discussed above have been filed. Notices of the filing of these additional applications have been issued as follows: (1) InterCapital Liquid Asset Fund, Inc. (noticed herein); (2) Dreyfus Money Market Instruments, Inc. (Investment Company Act Release No. 10161, March 17 1978)[1]; and (3) Federated Master Trust (Investment Company Act Release No. 10190, April 5, 1978). Collectively, the 13 applicants in the ten matters, captioned above, are referred to below as "Applicants," and the ten applications as "Applications". Each Application, with the exception of that of InterCapital, has been granted on a temporary basis (Investment Company Act Release Nos. 10027, 10161 and 10190, dated November 28, 1977, March 17, 1978, and April 5, 1978, respectively). InterCapital has not requested that its application be granted on a temporary basis.

[1] Dreyfus Money Market Instruments, Inc., seeks exemptive relief only in the event that the other applications, as noticed, are granted.

t appears to the Commission that it is appropriate in the public interest and consistent with the protection of investors to hold a hearing with respect to each of the Applications. Accordingly,

IT IS ORDERED, pursuant to Section 40(a) of the Act, that hearings on the Applications under the applicable provisions of the Act and Rules of the Commission thereunder, be held at a time and place to be fixed by further order in accordance with Rule 6 of the Commission's Rules of Practice (17 CFR 201.6).

It also appears to the Commission that the Applications involve common questions of law and fact. Accordingly,

IT IS FURTHER ORDERED, pursuant to Rule 10 of the Commission's Rules of Practice (17 CFR 201.10), that the hearings on these proceedings be joined for hearing of all matters in issue in such proceedings, and that such proceedings be, and hereby are, consolidated.

Any person other than the Applicants desiring to be heard or otherwise wishing to participate in this proceeding is requested to file with the Secretary of the Commission, on or before May 11, 1978, his application pursuant to Rule 9(c) of the Commission's Rules of Practice (17 CFR 201.9(c)), setting forth the nature and extent of his interest in the proceeding and any issues of law or fact which he desires to controvert or any additional issues which he deems raised by the Applications or by this Notice and Order. A copy of such request shall be served personally or by mail upon Applicants at the addresses noted above, and proof of such service (by affidavit or, in the case of an attorney-at-law, by certificate) shall be filed contemporaneously with the request. Persons filing an application to participate or be heard will receive notice of the date and place of the hearing and any adjournments thereof, as well as other actions of the Commission involving the subject matter of the proceeding.

IT IS FURTHER ORDERED that any officer or officers of the Commission, designated by it for that purpose, shall preside at said hearing. The officer so designated is hereby authorized to exercise all the powers granted to the Commisison under Sections 41 and 42(b) of the Act and to an Administrative Law Judge under the Commission's Rules of Practice.

The Division of Investment Management ("Division") has advised the Commission that, based upon examination of the Applications, the following matters are presented for consideration, without prejudice to the Division's specifying additional matters and questions upon further examination:

1. To what extent, if any, dilution of money market fund shareholders' interests may occur by reason of use of amortized cost valuation or rounding off of the price per share to the nearest cent on a $1.00 share; and

2. Under what circumstances and conditions, if any, are the requested exemptions appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

IT IS FURTHER ORDERED that at the aforesaid hearing attention be given to the foregoing matters.

IT IS FURTHER ORDERED that the Secretary of the Commission shall give notice of the aforesaid hearing by mailing a copy of this Notice and Order by certified mail to Applicants, The Dreyfus Corporation and Reserve Management Corporation; that notice to all other persons be given by publication of this Notice and Order in the "SEC Docket"; and that an announcement of the aforesaid hearing shall be included in the "SEC News Digest."

By the Commission.

George A. Fitzsimmons
Secretary

INVESTMENT COMPANY ACT OF 1940
Release No. 10202/April 12, 1978

In the Matter of

GPM BALANCED FUND, INC.

MEDITERRANEAN FUND, INC.

GARDNER AND PRESTON MOSS, INC.

STUDLEY, SHUPERT & CO., INC., OF BOSTON

date. The shareholders of Applicant, at a special meeting held on October 27, 1977, approved resolutions, previously adopted by the Applicant's Board of Directors, which, in essence, provided for the execution of the Agreement and certain other events necessary for the winding up of Applicant's affairs. Applicant states that on November 1, 1977, pursuant to the Agreement, substantially all of the assets of Applicant were transferred to the Trust in exchange for shares of beneficial interest in the Trust, and that those shares were contemporaneously distributed to Applicant's shareholders. Applicant states further that, immediately prior to the transfer of assets to the Trust, there were 583,443.025 shares of Applicant's common stock outstanding. The net asset value, in the aggregate, of such shares was $5,034,430.25.

Applicant represents that no brokerage commission was paid on the transfer of assets to the Trust. Applicant states that there are no existing shareholders of Applicant to whom distributions in complete liquidation of their interests have not been made, and that at the time of the filing of this application, Applicant had no shareholders.

Applicant states that it retained $21,046.00 in cash, and that these assets will not be invested in any securities; rather, they will be used to discharge Applicant's remaining liabilities. Applicant states that Articles of Transfer, as required by the Annotated Code of Maryland, were executed on November 1, 1977, by Applicant and the Trust, and were filed and accepted on November 2, 1977.

Section 8(f) of the Act provides, in pertinent part, that whenever the Commission, upon application, finds that a registered investment company has ceased to be an investment company, it shall so declare by order, and that, upon the taking effect of such order, the registration of such company shall cease to be in effect.

NOTICE IS FURTHER GIVEN that any interested person may, not later than November 20, 1978, at 5:30 p.m., submit to the Commission in writing a request for a hearing on the matter accompanied by a statement as to the nature of his interest, the reason for such request, and the issues, if any, of fact or law proposed to be controverted, or he may request that he be notified if the Commission shall order a hearing thereon. Any such communication should be addressed: Secretary, Securities and Exchange Commission, Washington, D.C. 20549. A copy of such request shall be served personally or by mail upon Applicant at the address stated above. Proof of such service (by affidavit or, in the case of an attorney-at-law, by certificate) shall be filed contemporaneously with the request. As provided by Rule 0-5 of the Rules and Regulations promulgated under the Act, an order disposing of the application will be issued as of course following said date unless the Commission thereafter orders a hearing upon request or upon the Commission's own motion. Persons who request a hearing, or advice as to whether a hearing is ordered, will receive any notices and orders issued in this matter, including the date of the hearing (if ordered) and any postponements thereof.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

George A. Fitzsimmons
Secretary

INVESTMENT COMPANY ACT OF 1940
Release No. 10451/October 26, 1978

In the Matters of

DAILY INCOME FUND, INC.
230 Park Avenue
New York, New York 10017
(812-4217)

DREYFUS MONEY MARKET INSTRUMENTS, INC.
767 Fifth Avenue
New York, New York 10022
(812-4229)

INSTITUTIONAL LIQUID ASSETS, INC.
8700 Sears Tower
Chicago, Illinois 60606
(812-4206)

INTERCAPITAL LIQUID ASSET FUND, INC.
130 Liberty Street
New York, New York 10006
(812-4230)

MERRILL LYNCH GOVERNMENT FUND, INC.

and

MERRILL LYNCH INSTITUTIONAL FUND, INC.
100 Federal Street
Boston, Massachusetts 02110
(812-4213)

SCUDDER CASH INVESTMENT TRUST
175 Federal Street
Boston, Massachusetts 02110
(812-4200)

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ıPORARY INVESTMENT FUND, INC.

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JST FOR SHORT-TERM FEDERAL SECURITIES
te 204—Webster Building
ıcord Plaza
1 Silverside Road
mington, Delaware 19810
2-4173)

TICE OF AND ORDER CANCELLING HEARING D GRANTING AMENDED APPLICATIONS FOR EMPTIONS FROM RULES 2a-4 AND 22c-1 UNDER E ACT.

Investment Company Act Release Nos. 9998 ɔvember 8, 1977), 10161 (March 17, 1978), 10000 ɔvember 8, 1977), 10201 (April 12, 1978), 9999 ɔvember 8, 1977), 9992 (November 4, 1977), and 9963 ovember 1, 1977), notices were issued of the filing of plications by: (1) Daily Income Fund, Inc.; (2) eyfus Money Market Instruments, Inc.; (3) stitutional Liquid Assets, Inc. ("ILA"); (4) Inter-pital Liquid Asset Fund, Inc.; (5) Merrill Lynch ɔvernment Fund, Inc. (formerly, White Weld Govern-ent Fund, Inc.) and Merrill Lynch Institutional Fund, :. (formerly, White Weld Money Market Fund, Inc.); Scudder Cash Investment Trust; and (7) Temporary ʻestment Fund, Inc. ("Temp Fund") and Trust for ort-Term Federal Securities ("Fed Fund") (these ıe companies are hereinafter referred to collectively "Applicants"), respectively.[1] Each of the Appli-nts, with the exception of Dreyfus Money Market struments, Temp Fund and Fed Fund, had requested ders pursuant to Section 6(c) of the Investment ımpany Act of 1940 (the "Act") exempting Applicants ım the provisions of Section 2(a)(41) of the Act and ıles 2a-4 and 22c-1 thereunder to permit, generally, ɜ valuation of their portfolio instruments on an ıortized cost basis. ILA requested, in addition, that ; principal underwriter, Salomon Brothers, be empted from the provisions of Rule 22c-1, to the tent necessary to permit ILA to value its assets at ıortized cost. Dreyfus Money Market Instruments, :., requested an order pursuant to Section 6(c) of the :t granting an exemption from Rule 22c-1 to permit it calculate its price per share to the nearest one cent ı a share value of $1.00. Temp Fund and Fed Fund requested an order pursuant to Section 6(c) of the Act granting an exemption from Rule 2a-4 to permit them to calculate their net asset values per share to the nearest one cent on share values of $1.00.[2]

The aforementioned notices gave interested persons an opportunity to request a hearing on the respective matters and stated, in each case, that an order disposing of that application would be issued as of course (following the expiration of the various periods specified in the notices) unless the Commission should thereafter order a hearing thereon, either upon request or upon the Commission's own motion. The Dreyfus Corporation and Reserve Management Corporation, registered investment advisers, filed requests for such hearings.

Each of the Applicants describes itself as a "money market" fund. Applicants, as well as certain other "money market" funds, requested exemptions in the nature of those described above, to the extent those orders might be necessary, either to permit them to value their assets or to calculate their prices per share in a manner inconsistent with the views of the Commission expressed in Investment Company Act Release No. 9786 (May 31, 1977) ("Release No. 9786"). Release No. 9786, among other things, stated the Commission's views that: (1) it is inconsistent generally with the provisions of Rule 2a-4 under the Act for "money market" funds to value their assets on an amortized cost basis, ignoring market factors, and (2) it is inconsistent with the provisions of Rule 2a-4 under the Act for such funds to "round off" calculations of their net asset values per share to the nearest one cent on a share value of $1.00.

On April 12, 1978, having determined that it was appropriate in the public interest and consistent with the protection of investors to hold a hearing with respect to the applications of the Applicants and those of other "money market" funds requesting similar relief, the Commission, pursuant to Section 40(a) of the Act, ordered hearings on such applications, and, pursuant to Rule 10 of the Commission's Rules of Practice, ordered that the applications be joined for hearing, and that such proceedings be consolidated (Investment Company Act Release No. 10201, April 12, 1978).[3]

ᒧA states in its application, as amended, that it is in e process of effecting a reorganization into a new ısiness entity ("Successor"), and requests that the der it seeks be applicable to such Successor. There-re, for purposes of the orders hereby issued, the term ʻpplicants," as defined herein, includes ILA and its ɹccessor.

[2]The Commission granted temporary exemptions to each of the Applicants except InterCapital Liquid Asset Fund, Inc. Investment Company Act Release Nos. 10027 (November 28, 1977) and 10161 (March 17, 1978).

[3]That hearing is now scheduled to commence on November 6, 1978.

he Applicants and The Reserve Fund, Inc., Dreyfus iquid Assets, Inc., and the Dreyfus Corporation (the atter three companies being non-party participants in ne aforementioned hearing, and who are hereinafter eferred to as the "Participants") have entered into a oint agreement ("Joint Agreement") whereby pplicants, *inter alia*, agreed to amend their applica-ons in certain respects, and the Participants, *inter lia*, agreed to withdraw any objections, and to waive ny right to object, to the granting of the applications f the Applicants if amended in accordance with the erms of the Joint Agreement.[4]

OTICE IS HEREBY GIVEN that the Applicants have, n accordance with the provisions of the Joint Agree-nent, amended their applications to request, pursuant o Section 6(c) of the Act, exemptions from the pro-isions of Rule 2a-4 and Rule 22c-1 under the Act, to ermit them to calculate their net asset values or rices, for the purpose of sales, redemptions and epurchases of their shares, to the nearest one cent on share value of $1.00. In addition, ILA has requested hat its principal underwriter, Salomon Brothers, be xempted from the provisions of Rule 22c-1 to the xtent necessary to permit ILA's net asset value to be alculated to the nearest one cent on a share value of 1.00.

s summarized in the above-cited prior notices of the pplications, Applicants state that investors who urchase their shares desire stable net asset values per hare, and a relatively constant return on their nvestments. Each of the Applicants seeks exemptions hich would, in its view, enable it largely to achieve hese objectives.

pplicants propose to value their portfolio securities in ccordance with the views of the Commission set forth n Release No. 9786. As noted above, in part, Release o. 9786 expressed the view that amortized cost aluation should not be utilized, except with respect to ortfolio securities with remaining maturities of 60 ays or less and provided that such valuation is deter-ined by the boards of directors to be appropriate.

ule 22c-1 adopted under the Act provides, in part, that o registered investment company or principal under-riter therefor issuing any redeemable security shall ell, redeem, or repurchase any such security except at price based on the current net asset value of such ecurity which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security. Rule 2a-4 adopted under the Act provides, as here relevant, that the "current net asset value" of a redeemable security issued by a registered investment company used in computing its price for the purposes of distribution and redemption shall be an amount which reflects calculations made substantially in accordance with the provisions of that Rule, with estimates used where necessary or appropriate. Applicants have requested exemptions from Rule 2a-4 and Rule 22c-1 to enable them to price their shares in the manner described above.

Section 6(c) of the Act provides, in part, that the Commission may, upon application, exempt any person, security or transaction, or any class or classes of persons, securities or transactions, from any pro-vision or provisions of the Act or the rules thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

Applicants assert that many of their investors require an investment vehicle that offers a constant net asset value per share and a relatively smooth stream of investment income. They state that many of their shareholders would seek other investment alternatives if such investors could not expect ordinarily that shares of Applicants could be purchased and redeemed at constant net asset values per share. Applicants submit that the exemptions they request are appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

Applicants have amended their applications to eliminate many of the conditions previously contained in their applications. These conditions are summarized in the above-cited notices of the applications. Appli-cants, in recognition of the fact that, unlike traditional investment companies with equity securities port-folios, they seek to provide investment vehicles having stable prices per share, have amended their applications to provide the following alternative conditions, which conditions were specified in the Joint Agreement, and have agreed that such conditions may be imposed in any order granting the exemptions they have requested:

> (1) Each Applicant states that its Board of Directors [Trustees, in the case of a trust], in supervising Applicants' respective operations and delegating special respon-sibilities involving portfolio management to Applicants' respective investment advisers, undertakes—as a particular responsibility within the overall duty of care owed to its

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[4] Applicants filed motions with the Administrative Law udge assigned to the hearing requesting, *inter alia*, hat their applications be severed from the onsolidated proceeding. The Administrative Law udge ordered such severances on October 6, 1978.

shareholders—to assure to the extent reasonably practicable, taking into account current market conditions affecting Applicants' investment objectives, that Applicants' respective prices per share as computed for the purpose of distribution, redemption and repurchase, rounded to the nearest one cent, will not deviate from $1.00;

(2) Each Applicant states that it will maintain a dollar-weighted average portfolio maturity appropriate to its objective of maintaining a stable price per share, and that it will not (i) purchase an instrument with a remaining maturity of greater than one year, or (ii) maintain a dollar-weighted average portfolio maturity in excess of 120 days; and

(3) Each Applicant states that its purchases of portfolio instruments, including repurchase agreements, will be limited to specified instruments of specified qualities in the case of all instruments other than U.S. Government issues and U.S. Government agency issues.[5]

s stated at note 2 above, all of the Applicants, with e exception of InterCapital Liquid Asset Fund, Inc., ere granted temporary exemptions to enable them to ilize amortized cost valuation, or calculate their net set values per share to the nearest one cent on share lues of $1.00, in each case under certain conditions which they agreed. Those temporary orders were to main in effect until final disposition of the plications by the Commission, including any subequent judicial review. Certain Applicants have dicated that, if the Commission grants their applications as amended, a transition period will be necessary permit Applicants to modify their operations to commodate the procedures proposed in the applicans. Accordingly, certain Applicants have requested at they be permitted to operate pursuant to their temporary orders for various periods of time subsequent to any order granting their applications.[6]

In view of the foregoing, particularly (1) on the basis of the applications as amended in the manner described above, and (2) the agreement of the Participants to withdraw their objections to the granting of the applications without a hearing and to waive any right to object thereto, the Commission finds that a hearing on the Applicants' applications is no longer necessary in the public interest or for the protection of investors, and that the granting of the requested exemptions is appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Accordingly,

IT IS ORDERED, pursuant to Section 38(a) of the Act, that the hearing on the applications of Applicants is hereby cancelled, and that the order for a hearing on these applications is hereby rescinded, effective forthwith.

IT IS FURTHER ORDERED, pursuant to Section 6(c) of the Act, that the requested exemptions from the provisions of Rule 22c-1 and Rule 2a-4 promulgated under the Act be, and hereby are, granted, effective forthwith, each subject to the conditions set forth in the respective amended applications and described above.

IT IS FURTHER ORDERED, pursuant to Sections 38(a) and 6(c) of the Act, that the orders temporarily granting Applicants' (other than InterCapital Liquid Asset Fund, Inc.) applications as previously noticed be, and hereby are, extended (to the extent they otherwise will have expired by their terms) for such times as may be necessary for those Applicants affected to modify their operations to implement the pricing procedures set forth in their applications as amended: provided, however, that any such extension shall terminate on February 28, 1979.

By the Commission.

George A. Fitzsimmons
Secretary

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[5] With respect to the condition relating to portfolio uality, each Applicant has specified particular quality nitations. These limitations are set forth in the spective applications, as amended. Certain Applints have agreed to quality limitations which differ in me respects from those set forth in the prior notices f their applications. However, these modifications do ot establish quality limitations lower than those to hich other Applicants have agreed and which were set rth in the notices of the applications of those other pplicants.

[6] The Division of Investment Management has advised the Commission that no Applicant has asked that the temporary orders be extended beyond February 28, 1979. None of the Applicants objects to such extension of the temporary orders.