257-1 [redacted]

23 JUL 1980

ACTION MEMORANDUM

TO	:	The Commission
FROM	:	The Division of Investment Management MEL
SUBJECT	:	Temporary Exemptive Rule for Money Market Funds.
RECOMMENDATION	:	That the Commission issue the attached release adopting Rule 6c-5(T) under the Investment Company Act of 1940 ("Act"), on an emergency basis, in order to provide money market funds affected by the rescission of credit control regulations with exemptions from Sections 17(a), 12(d)(1) and 13(a)(3) of the Act and thereby: (1) permit "clone" money market funds to generate liquidity by transferring, or selling their portfolio instruments to certain affiliated persons, and (2) enable other money market funds to acquire, pursuant to offers of exchange, securities issued by "clone" funds.
ACTION REQUESTED BY	:	Seriatim consideration.
OTHER DIVISIONS OR OFFICES CONSULTED	:	None.
RESPONSIBLE STAFF MEMBERS	:	Kenneth S. Gerstein - 23023 Jeffrey B. Bailey - 23033
SUNSHINE ACT STATUS	:	Closed meeting.
NOVEL, UNIQUE OR COMPLEX ISSUES	:	None.

DISCUSSION

On July 21, 1980, the Commission issued a general statement of policy expressing its views with respect to various issues arising under the federal securities laws that should be considered by boards of directors of money market funds as a result of the rescission of credit control regulations by the Board of Governors of the Federal Reserve System ("Board"). 1/ One consequence of the Board's action, which eliminates the need for money market funds to maintain "reserves" after August 11, 1980, will probably be that "clone" funds organized to minimize the effect of the Board's regulations upon previously existing money market funds may experience significant net redemptions of their shares. The basis of this concern and its implications are set forth fully in the general statement of policy. In addition, that document outlines several procedures that boards of directors of money market funds might wish to consider utilizing in order: (1) to transfer promptly and efficiently the interests of shareholders from "clone" funds to "nonclones," and (2) to satisfy the high level of anticipated net redemptions.

In reality, the use of these unusual procedures would result in de facto mergers of "clones" into other money market funds without the time and expense ordinarily associated with effecting a statutory merger or a reorganization. Although the Commission did not endorse or mandate the use of these procedures in the general statement of policy, in situations where a fund's board of directors properly determines to utilize such methods, certain provisions of the Investment Company Act of 1940 ("Act") could prove to be obstacles. As a result, the general statement of policy indicated that the Commission expected to consider the adoption of certain temporary exemptive rules designed to facilitate certain transactions. The Division continues to believe that the adoption of an exemptive rule would be appropriate under the unusual circumstances confronting the money market fund industry.

Accordingly, the Division recommends that the Commission adopt Rule 6c-5(T) under the Act, on an emergency basis, to provide certain temporary exemptions from the provisions of Sections 17(a), 12(d)(1) and 13(a)(3), to money market funds. These exemptions would, subject to a variety of protective conditions: (1) permit "clone" funds and other new money market funds to transfer or to sell portfolio instruments to affiliated persons, including affiliated money market funds, in order to assist such companies in meeting redemptions, and (2) permit "nonclone" money market funds to acquire securities issued by "clone" funds and other new money market funds pursuant to offers of exchange, in order to facilitate the prompt transfer of shareholder interests from "clones" (and other new money market funds) to "nonclones."

The release which the Division recommends be issued by the Commission (Attachment A hereto) discusses in detail the necessity and appropriateness of the rule, and outlines its operation and applicability. Although money

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1/ Investment Company Act Release No. 11263 (July 21, 1980). Attachment B hereto.

market funds may be utilizing a variety of unusual procedures to respond appropriately to the rescission of credit controls, the exemptions that would be provided by Rule 6c-5(T) are neither extraordinary nor extreme. The exemption from Section 17(a) of the Act provided by the rule would be similar to the exemption now provided by Rule 17a-8 with respect to mergers of affiliated investment companies, and that which would be provided if the already proposed amendment to Rule 17a-7 were adopted. However, the rule would impose certain additional requirements. Finally, the exemptions provided from the provisions of Section 12(d)(1) and 13(a)(3) will remove certain "technical" limitations which the Act would otherwise place upon the making and effecting of offers of exchange by registered investment companies.

CONCLUSION

In view of the extraordinary circumstances now being faced by money market funds, the Division recommends that the attached release be issued adopting Rule 6c-5(T).

ATTACHMENTS

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release No. IC-]

Temporary Rule Providing Exemptions to Certain Money Market Funds

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Commission is adopting, on an emergency basis, a temporary rule under the Investment Company Act of 1940 ("Act"): (1) to permit certain registered investment companies and other persons to acquire portfolio instruments of a money market fund of which they are affiliated persons, and (2) to exempt certain registered investment companies from the provisions of two sections of the Act which might otherwise prohibit such companies from purchasing securities issued by another investment company. Now that the Board of Governors of the Federal Reserve System ("Board") has announced the rescission of its credit control regulations, the adoption of this rule should assist boards of directors of money market funds, organized after the adoption of credit control regulations by the Board on March 14, 1980, in taking various actions to address the implications of rescission with respect to the operations of such money market funds. The purpose of the temporary rule is to provide appropriate exemptive relief to minimize the undue disruptions of the operations of certain money market funds and other unnecessary hardships that might otherwise occur as a result of the termination of credit controls.

EFFECTIVE DATE: July 24, 1980.

FOR FURTHER INFORMATION CONTACT: Kenneth S. Gerstein, Special Counsel (202-272-3023), or Jeffrey B. Bailey, Esq. (202-272-3033), Division of Investment Management, Securities and Exchange Commission, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: On July 21, 1980, the Commission issued a general statement of policy expressing its views concerning the implications under the federal securities laws for registered investment companies, particularly "money market" funds, which have been subject to credit control regulations adopted on March 14, 1980, and thereafter amended, by the Board of Governors of the Federal Reserve System ("Board"), as a result of the Board's decision to rescind such regulations. 1/ In addition to discussing some of the matters that the Commission believes should be considered by boards of directors of money market funds affected by the Board's action, the general statement of policy stated that the Commission would institute a rulemaking proceeding to adopt a temporary rule under the Investment Company Act of 1940 ("Act") [15 U.S.C. 80a-1 et seq.] permitting certain transactions in order to enhance the ability of money market funds which have been subject to the Board's regulations to take certain steps to protect and to further the interests of shareholders and investors.

1/ Investment Company Act Release No. 11263 (July 21, 1980) [FR]. The general statement of policy describes generally the nature of the regulations and the method by which such regulations will be eliminated.

Accordingly, the Commission has adopted Rule 6c-5(T) [17 CFR §270.6c-5(T)]. Because the rule is designed to minimize the disruption of the operations of money market funds which might otherwise begin to occur on July 28, 1980, Rule 6c-5(T) is being adopted on an emergency basis. On appropriate notice, and at such time as the exemptions provided by the rule are no long necessary, the rule may be rescinded in whole or in part.

THE NEED FOR THE RULE

As discussed more fully in the general statement of policy issued on July 21, 1980, money market funds organized after March 14, 1980 ("new companies"), may experience significant net redemptions of their shares by investors beginning on July 28, 1980. In addition, it is likely that many such investors will seek to purchase shares of money market funds which were organized prior to March 14, 1980 ("existing companies"), and have, therefore, been affected to a lesser degree by the Board's regulations. As a result, among other things, boards of directors of new companies may find it necessary and appropriate to consider various methods of transferring the interests of shareholders from new companies to existing companies in a prompt and efficient manner, and of generating sufficient liquidity to satisfy the anticipated high level of net redemptions.

In this regard, two of the alternatives discussed in the general statement of policy were: (1) the use of offers of exchange made to shareholders of new companies, and (2) the sale of portfolio instruments by new companies to affiliated existing companies. Subject to various conditions, Rule 6c-5(T) will permit these transactions to be effected. However, prior to implementing such actions, boards of directors of each of the registered investment companies involved should satisfy themselves that such actions are appropriate and in the best interests of shareholders, and should consider carefully each of the concerns expressed by the Commission in the general statement of policy respecting the types of transactions contemplated by the rule.

OPERATION OF THE RULE

Rule 6c-5(T) is exemptive in nature. 2/ It provides three basic types of exemptions, for two types of transactions, each of which is discussed below. 3/ Paragraph (a) of the rule defines the terms "Board's regulations," "existing company," and "new company."

2/ Although the rule may be available to a company, as noted above and as discussed more fully in the general statment of policy, certain matters should be considered by the boards of directors before electing to effect the transactions permitted by the rule.

3/ Transactions in reliance upon Rule 6c-5(T) must be effected prior to November 21, 1980.

1. Sale of Portfolio Instruments.

Boards of directors of certain new companies may wish to transfer portfolio securities to affiliated persons of such companies as one way of enhancing liquidity and meeting redemptions. Such transactions would normally be prohibited by the provisions of Section 17(a) of the Act [15 U.S.C. 80a-17(a)]. 4/ However, under certain circumstances, the ability to effectuate these transactions might be an efficient and economical method to assist meeting the redemptions of shares anticipated to occur with respect to new companies. Such ability might also enable the companies and persons involved in the transaction to transfer and to obtain assets without some of the transactions costs normally associated with sales and purchases of portfolio instruments. The rule permits new companies to transfer or to sell portfolio instruments to affiliated investment companies, whether or not such affiliated company is a money market fund, and to other affiliated persons, where the five conditions of the rule are met.

4/ Registered investment companies that are part of the same "complex" of investment companies are generally affiliated persons of each other. Section 2(a)(3)(C) of the Act. Moreover, as here relevant, each series of shares of a registered open-end investment company meeting the provisions of Section 18(f)(2) of the Act [15 U.S.C 80a-18(f)(2)] would be deemed to be separate companies which are affiliated persons of each other. See Section 2(a)(8) of the Act [15 U.S.C. 80a-2(a)(8)].

Paragraph (b) of Rule 6c-5(T) is designed to permit money market funds which commenced the public offerings of their shares subsequent to March 14, 1980, 5/ to transfer, sell or exchange their portfolio instruments for appropriate consideration to affiliated persons of such companies. 6/ In order to protect the interests of each of the investment companies involved, paragraph (b)(1) of Rule 6c-5(T) requires boards of directors of such companies, including a majority of the directors who are not interested persons of such companies, to make certain specified findings. 7/ In addition, to further minimize the potential for any material dilution, paragraph (b)(2) of the rule specifies the method used to determine the price at which instruments may be sold in reliance upon the rule. 8/ Paragraph (b)(3) of Rule 6c-5(T) requires the board of directors of a new company to consider the potential financial impact upon shareholders when determining

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5/ Such companies, termed "new companies," are defined by paragraph (a)(3) of the rule to include any registered open-end management investment company which would be a "covered creditor" under the Board's regulations and which commenced the public offering of its shares subsequent to March 14, 1980.

6/ The term "affiliated person" is defined by Section 2(a)(3) of the Act [15 U.S.C. 80a-2(a)(3)].

7/ These findings are similar to those which must be made by directors of registered investment companies relying upon Rule 17a-8 under the Act [17 CFR §270.17a-8] in connection with mergers of affiliated investment companies.

8/ In this regard, the rule is similar to Rule 17a-7 under the Act [17 CFR §270.17a-7] as it has been proposed to be amended. See Investment Company Act Release No. (, 1980) [FR].

which portfolio instruments are to be transferred; in effect, it will have to consider the effect of transfers of portfolio instruments upon such company's yield and overall portfolio quality. Where such instruments are to be transferred to another registered investment company, paragraph (b)(4) of the rule requires that such instruments come within the investment limitations of such other company.

Finally, paragraph (b)(5) requires the maintenance of certain records in connection with the transactions permitted by the rule.

2. Offers of Exchange.

As noted above, boards of directors may, in some instances, determine to utilize offers of exchange as one method for transferring the interests of investors from new companies to existing companies. In situations where a money market fund has determined it to be appropriate to make such an offer of exchange to the shareholders of a new company, Rule 6c-5(T) provides two exemptions to the money market fund which will be acquiring securities issued by the new company. These exemptions will be necessary because: (1) the provisions of Section 12(d)(1) of the Act [15 U.S.C. 80a-12(d)(1)] generally prohibit any registered investment company from purchasing securities issued by another investment company in excess of certain percentage limitations, and (2) the fundamental policies of the money market funds making such acquisitions may preclude the purchase of securities issued by another investment company. In the latter case, the purchase of such securities would ordinarily violate Section 13(a)(3) of the Act [15 U.S.C. 80a-13(a)(3)], which prohibits a registered investment company from deviating from any investment policy which is changeable only if authorized by shareholder vote or from any "fundamental" policy recited in its registration statement pursuant to Section 8(b)(3) of the Act [15 U.S.C. 80a-8(b)(3)]. 9/

Under the highly unusual circumstances now confronting money market funds as a result of the Board's action, the Commission has determined it to be appropriate to facilitate offers of exchange by granting certain exemptions to money market funds which seek to acquire, pursuant to offers of exchange, securities issued by a new company. Such offers of exchange might be an effective method for the efficient and orderly transfer of the interests of shareholders of new companies to other money market funds.

Paragraphs (c) and (d) of Rule 6c-5(T) exempt certain money market funds ("existing company") from the provisions of Sections 12(d)(1) and 13(a)(3) of the Act, respectively. 10/ In each case, such exemptions are conditioned upon: (1) the board of directors of the existing company

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9/ Under the circumstances, the Commission would not require a money market fund to modify the stated policies contained in its registration statement where it temporarily acquires and holds securities issued by another money market fund pursuant to an offer of exchange of the type discussed herein.

10/ The money market funds so exempted must meet the definition of "existing company" set forth in paragraph (a)(2) of the rule (i.e., be a money market fund making a continuous public offering of its shares before the imposition of credit controls).

and of the new company approving the making of an offer of exchange (paragraph (c)(2)); (2) the ability of the existing company to purchase and to hold securities issued by another investment company consistent with applicable state law (paragraph (c)(3)) and (3) the existing company disposing of the securities issued by the new company prior to November 21, 1980 (paragraph (c)(1)). Finally, paragraph (c)(1) further requires that the investment adviser, and administrator (if any), of the existing company not charge any investment advisory fee or fee for administrative services to the existing company on account of the securities of the new company being held.

PROCEDURAL MATTERS

The Commission believes that it is necessary and appropriate to adopt Rule 6c-5(T) immediately. In accordance with Section 553(d) of the Administrative Procedure Act ("APA") [15 U.S.C. 553(d)], because Rule 6c-5(T) is exemptive in nature, publication 30 days before the rule's effective date is unnecessary. In accordance with Section 553(b) of the APA [5 U.S.C. 553(b)(B)], the Commission for good cause finds that notice and opportunity for public comment are similarly not required because such notice and opportunity for public comment would be impracticable and contrary to the public interest.

TEXT OF THE RULE

Part 270 of Chapter II of Title 17 of the Code of Federal Regulations is hereby amended as follows:

By adding §270.6c-5(T) to read as follows:

§270.6c-5(T) Temporary exemptions for certain money market funds and certain affiliated persons thereof.

(a) Definitions.

(1) "Board's regulations" shall mean the credit control regulations applicable to registered investment companies adopted by the Board of Governors of the Federal Reserve System on March 14, 1980 [12 CFR 229.11 et seq.], and amended thereafter;

(2) "Existing company" shall mean any registered open-end, management investment company (or series of securities of such company) which commenced the continuous offering of its shares to the public on or prior to March 14, 1980, and which would be a "covered creditor" under the Board's regulations; and

(3) "New company" shall mean any registered open-end, management investment company (or series of securities of such company) which commenced the public offering of its shares subsequent to March 14, 1980, and which would be a "covered creditor" under the Board's regulations.

(b) Any transaction, occurring prior to November 21, 1980, whereby a new company transfers, sells or exchanges portfolio instruments for appropriate consideration to an affiliated person of such company, shall be exempt from the provisions of Section 17(a) of the Act; Provided, That:

(1) the boards of directors of each registered investment company participating in the transaction, including a majority of the directors of each such registered investment company who are not interested persons of such company, determine (A) that participation in such transaction is in the best interest of their respective companies, and (B) that the interests of existing shareholders of their respective companies will not be diluted as a result of such transaction;

(2) the portfolio instruments of the new company are transferred, sold or exchanged at market value or, where market quotations are not readily available, at a price determined by reference to current market factors, except that portfolio instruments may be sold at their amortized cost values where, in the aggregate, the market value of all such instruments involved in the transaction (or the price of such instruments determined by reference to current market factors) does not differ by more than 1/2 of 1 percent from the amortized cost value of such instruments;

(3) the board of directors of the new company, in selecting those portfolio instruments to be transferred, sold or exchanged considers the potential financial impact upon shareholders of the new company;

(4) where such instruments are acquired by another registered investment company, the instruments meet all applicable investment restrictions and policies of such other company; and

(5) each registered investment company involved in the transaction maintains, for a period of not less than five years (the first two years in an easily accessible place), a record of (A) its board of directors' consideration of the matters set forth in paragraphs (b)(1)-(4) above, including the basis for the board of directors' conclusions, and (B) the value of any portfolio instruments sold and the method by which such value was determined.

(c) An existing company which, prior to November 21, 1980, purchases or otherwise acquires, pursuant to an offer of exchange, securities issued by a new company of which it is an affiliated person, shall be exempt from the provisions of Section 12(d)(1) of the Act to the extent necessary to permit such purchases or acquisitions; Provided, That:

(1) such securities are sold, exchanged or otherwise disposed of, prior to November 21, 1980, and no investment advisory fee, or fee for administrative services, is charged to the existing company by its investment adviser or administrator on account of the securities of a new company held by the existing company;

(2) the boards of directors of the existing company and the new company. including a majority of the directors thereof who are not interested persons of such company, each have considered and approved the making of such offer of exchange; and

(3) the existing company, pursuant to applicable state law, has the authority under the circumstances to purchase and to hold shares of another registered investment company.

(d) An existing company which, prior to November 21, 1980, purchases or otherwise acquires, pursuant to an offer of exchange, securities issued by a new company of which it is an affiliated person, shall be exempt from the provisions of Section 13(a)(3) of the Act to the extent necessary to permit such purchases or acquisitions, where the conditions set forth in paragraphs (c)(1)-(3) above are satisfied.

STATUTORY BASIS: Rule 6c-5(T) is adopted pursuant to Section 6(c) [15 U.S.C. 80a-6(c)] and Section 38(a) [15 U.S.C. 80a-37(a)] of the Act.

By the Commission.

George A. Fitzsimmons
Secretary.

July 24, 1980.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 231 and 271

[Release Nos. 33-6224 , and IC-11263]

Effect of the Termination of Credit Controls on the Operations of Certain Registered Investment Companies Including Money Market Funds

AGENCY: Securities and Exchange Commission.

ACTION: General Statement of Policy.

SUMMARY: The Securities and Exchange Commission announces a general statement of policy concerning implications under the federal securities laws of the rescission of credit control regulations applicable to certain registered investment companies, including "money market" funds. The credit control regulations were promulgated by the Board of Governors of the Federal Reserve System ("Board") on March 14, 1980, and subsequently amended on March 28, 1980, and May 22, 1980, pursuant to the Board's authority under the Credit Control Act of 1969, as implemented by Executive Order of the President. On July 3, 1980, the Board announced that its credit control regulations would be eliminated with respect to the weekly reporting periods beginning on July 28, 1980. This general statement of policy expresses the Commission's views concerning various disclosure obligations under the Securities Act of 1933 and various regulatory considerations under the Investment Company Act of 1940, which should promptly be considered by boards of directors of registered investment companies which have been subject to the Board's regulations.

EFFECTIVE DATE: July 21, 1980.

FOR FURTHER INFORMATION CONTACT: Kenneth S. Gerstein, Special Counsel (202-272-3023), Gene A. Gohlke, Examination Program Coordinator (202-272-2024) or Jeffrey B. Bailey, Esq. (202-272-3033), Division of Investment Management, Securities and Exchange Commission, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: On July 3, 1980, the Board of Governors of the Federal Reserve System ("Board") announced its decision to rescind its credit control regulations [12 CFR §229.11-.15] applicable to certain registered investment companies, including "money market" funds and short-term unit investment trusts. The Board's regulations, which were adopted on March 14, 1980, and thereafter amended on March 28, 1980, and May 22, 1980, required each investment company subject thereto to maintain a noninterest bearing special deposit with the Federal Reserve Bank in the district where such investment company had its principal place of business equal to a specified percentage of the amount by which the average of the daily amounts of its "covered credit" during specified weekly periods exceeded a specified "base" amount, subject to certain adjustments. 1/

1/ 45 FR 17927 (March 19, 1980), 45 FR 22883 (April 4, 1980), and 45 FR 37413 (June 3, 1980). The last amendment to the Board's regulations reduced from 15 percent to 7.5 percent the proportion of each investment company's covered credit, in excess of its base, required to be deposited under the regulations.

The Board's action provides that the week ending July 27, 1980, shall be the last reporting period for which special deposits will be required. Such special deposits are required to be made on August 4, 1980, and will be refunded on August 11, 1980. 45 FR 46064 (July 9, 1980).

In response to adoption of the Board's regulations, the Commission issued a general statement of policy concerning some of the implications of such regulations under the federal securities laws in order to provide the boards of directors of registered investment companies with guidance respecting various disclosure obligations under the Securities Act of 1933 ("1933 Act") [15 U.S.C. 77a et seq.] and various regulatory matters under the Investment Company Act of 1940 ("1940 Act") [15 U.S.C. 80a-1 et seq.]. 2/ Consistent with the views expressed in that general statement of policy, and in recognition of their responsibilities, many money market funds and their investment advisers implemented a variety of actions designed to modify the operations of such investment companies to accommodate the impact of the Board's regulations while minimizing inequities to existing shareholders and investors.

In particular, a number of so-called "clone" funds ("new funds") were organized by investment advisers to duplicate already existing money market funds ("existing funds"). The purpose of each new fund was to absorb new sales of shares which, if sold by the existing fund, could have increased the amount of its special deposit and, thus, adversely affected dividends payable to shareholders of the existing fund. 3/ In order to enhance the ability of investment companies to

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2/ Investment Company Act Release No. 11088 (March 14, 1980) [45 FR 17954, March 20, 1980].

3/ Because the credit control regulations imposed a special deposit, generally, only on assets in excess of the outstanding "covered credit" on March 14, 1980 ("base"), existing funds would have to make special deposits only if their assets (covered credit) increased above their base amounts.

take a variety of responsive actions, the Commission adopted Rule 6c-4(T) [17 CFR §270.6c-4(T)], which provides money market funds subject to the Board's regulations, and companies and persons dealing with such funds, with temporary exemptions on an emergency basis from various provisions of the 1940 Act and the rules adopted thereunder. 4/

The Commission believes that rescission of the Board's regulations will have various implications with respect to the operations of certain money market funds. 5/ Accordingly, this general statement of policy is intended to provide guidance to the directors of registered investment companies which have been subject to the Board's regulations respecting compliance and disclosure responsibilities of such investment companies under the federal securities laws arising from termination of credit control regulations. In addition, it will outline one possible method that boards of directors may wish to utilize to transfer efficiently the interests of investors in new funds to existing funds, and one possible method that may be available for new funds to achieve the high degree of liquidity necessary to meet redemptions. It is not, however,

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4/ Investment Company Act Release No. 11137 (April 22, 1980) [45 FR 28307, April 29, 1980].

5/ The rescission of the credit control regulations will also have an impact on short-term unit investment trusts. However, the implications of the Board's action with respect to short-term unit investment trusts should simply be that special deposits of existing trusts will be refunded to the trustees of the trusts and then distributed to unitholders. Thus, this general statement of policy relates principally to open-end, management investment companies investing in short-term debt obligations, commonly termed "money market" funds.

intended to address all of the issues which may arise from the Board's action, which issues may nevertheless be appropriate for directors to consider.

DISCLOSING THE ELIMINATION OF SPECIAL DEPOSITS

The primary implication of the Board's rescission of its credit control regulations will be that money market funds no longer will be required to maintain special deposits and that special deposits now being held by Federal Reserve Banks will be refunded. When investment companies are able to invest the assets previously constituting special deposits, investors in these funds, generally, should receive somewhat increased yields. Thus, to the extent that the prospectuses of money market funds currently disclose the existence and consequences of the special deposit requirement, money market funds should amend their prospectuses as soon as practicable to reflect the investment and other implications of the elimination of the need to make special deposits. In this regard, the Commission will not object to the use of a Rule 424(c) [17 CFR §230.424(c)] "sticker" by an investment company to amend its prospectus. In addition, the Commission will not object to continued use of the current prospectus to sell securities during the time reasonably necessary to amend the prospectus to make appropriate disclosures. 6/

6/ Because shareholders of money market funds affected by the credit control regulations in many cases may have elected to have dividends reinvested, the Commission expects that any disclosures made by investment companies will be furnished promptly to existing shareholders, as well as to all future investors.

In certain cases, prompt disclosure of other matters also will be necessary and appropriate. For example, an existing fund which adopted certain restrictive policies respecting the sale of its shares to minimize the impact of the special deposit requirement on existing shareholders should disclose any revision of such policies. 7/ Similarly, where any other modifications of a money market fund's policies, objectives or services are made as a result of the elimination of credit control regulations, the fund should promptly make appropriate disclosure of such modifications. The matters discussed hereinafter also may necessitate certain additional disclosures to investors.

IMPLICATIONS FOR "NEW" MONEY MARKET FUNDS

As noted above, certain new funds were organized after the adoption of the credit control regulations by the investment advisers to existing funds for the purpose of minimizing the impact that additional sales of shares would otherwise have had on the existing funds. In most cases, these new funds are rather similar, if not identical, to the existing funds which they duplicate. However, the yields currently being earned by existing funds in most cases exceed those being earned by new funds by amounts which exceed differences

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7/ As discussed at p. 19, *infra*, the Commission believes that certain matters should be considered by the boards of directors of money market funds before eliminating or modifying restrictive sales policies.

attributable solely to the larger special deposits maintained by the new funds. 8/

Under these circumstances, many shareholders of new funds may decide to redeem their shares and to seek to purchase either (1) shares of the existing fund in the same "complex" of investment companies (if available) or (2) shares of another money market fund (whose shares may previously have been unavailable because of sales restrictions adopted after the institution of the special deposit requirement). In some cases, the level of such redemptions, coupled with reduced sales of new shares of such funds, may have serious implications respecting the future viability of new funds. As a result, directors of a new fund may have to consider seriously whether: (1) to terminate the business activities of and to liquidate the new fund; (2) to modify the fundamental investment objectives of the new fund to provide a continued business purpose; or (3) to enter into a merger, consolidation or reorganization with another money market fund. In some instances, shareholder approval may be necessary, and certain of these alternatives could cause the new fund to incur significant expenses.

Thus, the Commission believes that boards of directors of new funds should consider the effect of rescission of the credit control regulations on the continued viability of new funds as soon as reasonably

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8/ These differences may, in part, be due to: (1) the higher expense ratios of new funds, and (2) the fact that existing funds still hold in their portfolios some higher yielding debt obligations which were acquired prior to the recent decline in short-term interest rates.

practicable. Further, after that matter has been considered, it would be appropriate for new funds then to disclose their boards' conclusions as to any future courses of action they are likely to recommend that the new funds pursue. Most importantly, if the board of directors of a new fund determines that it is likely to seek shareholder approval of a fundamental change in the nature of a new fund's business or of a plan of liquidation or reorganization, or if the board determines to use an offer of exchange to transfer shareholders' interests to the existing fund, the board should carefully consider the appropriateness of creating a reserve account or some other protective device to assure that shareholders of the new fund who have benefited from the use of that investment vehicle each bear their fair share of any anticipated expenses, including unamortized organization expenses. Of particular concern to the Commission is the possibility that, if a new fund were to suffer significant net redemptions, the remaining shareholders of the new fund would bear a disproportionate portion of the expenses associated with liquidating, reorganizing or restructuring the fund. 9/ In the Commission's view, failure of an investment company to take these anticipated expenses promptly into account may, under certain circumstances, raise questions as to whether a new fund's shares are

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9/ Of course, if the investment adviser or underwriter of the new fund agreed to bear all of such expenses, the creation of a reserve account or some other protective device may not be necessary. The Commission would not view such agreement in these unusual circumstances to be a joint enterprise within the meaning of Section 17(d) of the Act [15 U.S.C. 80a-17(d)] and Rule 17d-1 thereunder [17 CFR §270.17d-1]. See Rule 17d-1(d)(8).

being priced properly 10/ and, depending upon all of the facts and circumstances, may raise questions concerning a breach of fiduciary duty on the part of those persons responsible for such decisions. 11/

The Commission cannot predict the magnitude of net redemptions of shares that may be experienced by new funds. However, it is possible that such funds may be faced with sufficient redemptions to require the sale of portfolio securities prior to maturity. In view of this possibility, the board of directors of a new fund should consider the appropriateness of maintaining an unusually high degree of liquidity so that an unusually high volume of shareholder orders to redeem shares can be satisfied promptly, 12/ with minimum disruption of the fund's activities and operations.

10/ Rule 22c-1 under the 1940 Act [17 CFR §270.22c-1] requires that redeemable securities of investment companies be sold and redeemed at the current net asset value per share next computed after receipt of an order to buy or to redeem such securities. Rule 2a-4 under the 1940 Act [17 CFR §270.2a-4], among other things, requires that expenses be included in calculating an investment company's current net asset value per share.

11/ Section 36(a) of the 1940 Act [15 U.S.C. 80a-35(a)], in pertinent part, authorizes the Commission to seek injunctive or other relief where any officer, director, investment adviser, or principal underwriter of a registered investment company has engaged, or is about to engage, in any act or practice constituting a breach of fiduciary duty involving personal misconduct.

12/ Although Section 22(e) of the Act [15 U.S.C. 80a-22(e)] permits redemption requests to be satisfied within seven days of receipt, some money market funds have undertaken to process shareholder purchase and redemption requests more expeditiously. Unless those undertakings are qualified, or have been modified with ample notice to all shareholders, it is expected that such funds will adhere to the more restrictive time periods which they have disclosed in their prospectuses.

POSSIBLE ARRANGEMENTS FOR ORDERLY TRANSITIONS

As noted above, two significant concerns immediately confronting boards of directors of new funds appear to be: (1) the expected movement of investors from new funds to existing funds, and (2) the accompanying high level of redemptions that may be experienced by new funds. The Commission recognizes that a variety of methods might be utilized to deal with these concerns promptly and efficiently to provide investors in new funds with a means to exchange their shares promptly for shares of existing funds, and to enhance the liquidity of new funds. In this regard, outlined below are certain methods which might be utilized to effect exchanges of shares of new funds for shares of existing funds, and to meet redemptions, in instances where the board of directors has determined that it is in the best interests of shareholders of the new fund to suspend its operations.

1. Offers of Exchange.

In providing for an orderly transition, boards of directors of existing funds, and the principal underwriters and investment advisers of such funds, may wish to make offers of exchange to shareholders of new funds. Such offers of exchange, when based upon the relative net asset values per share of the money market funds involved, are permitted under Section 11(a) of the 1940 Act [15 U.S.C. 80a-11(a)] without orders of the Commission. 13/ Such offers would normally have to be accompanied by a statutory prospectus to comply with the prospectus delivery requirements of Section 5 of the 1933 Act [15 U.S.C. 77(e)]. In these unusual circumstances where the existing fund and the new fund are for all practical purposes almost identical in structural make-up and operation, including having the same investment adviser and directors, to satisfy the requirement that a statutory prospectus be provided the Commission will not object to the use of a Rule 424(c) prospectus which consists of a document that: (1) incorporates by reference the prospectus of the new fund already delivered, and (2) includes such additional information as is necessary to constitute

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13/ Anticipated liquidation expenses and unamortized organization expenses of a new fund must be fully and accurately reflected in the net asset value per share of that fund, regardless of the method utilized to value such fund's assets or to price such fund's shares. See p. 8, supra, concerning the establishment of liquidation reserves. The Commission believes that, if these expenses are not reflected in this manner, Section 11(a) of the 1940 Act would require the investment company making such an offer to obtain an order of the Commission prior to the making of an offer of exchange. On the other hand, to the extent that the investment adviser or principal underwriter of a new fund agreed to bear such expenses it would not be necessary to reflect such expenses in the new fund's net asset value per share. As noted above at n. 9, the Commission will not view such an agreement in these unusual circumstances as a joint enterprise within the meaning of Section 17(d) of the Act and Rule 17d-1 thereunder.

the complete prospectus of the existing fund. 14/ Investment companies may rely on this Commission position only where the objectives, services and features of the new fund and existing fund are essentially the same. Of course, the Commission would not object if a statutory prospectus of the existing fund is sent with the offer of exchange.

Offers of exchange may be useful in achieving a prompt and orderly movement of shareholders from new funds to existing funds. 15/ Thus, directors of new funds and existing funds may wish to consider various methods, consistent with applicable state law, to effectuate exchanges of shares. Such offers of exchange are not subject to the Commission's rules under the Securities Exchange Act of 1934 [15 U.S.C. 78a *et seq.*] respecting tender offers, which do not apply to equity securities of registered open-end investment companies. 16/ However, because an offer of exchange is an offer of a security as

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14/ The financial information contained in the currently effective prospectus of the existing fund, or any more recent financial information contained in a periodic report to shareholders, may be utilized in the Rule 424(c) prospectus. In addition, shareholders should be advised to request a prospectus of the existing fund if they have not retained their copies of the new fund's prospectus.

15/ This assumes, of course, that the existing fund has the authority under state law through its corporate charter or articles of incorporation to own, purchase or hold the shares of another registered investment company.

16/ *See* Sections 14(d)(1) and 12(g)(2)(B) of the Securities Exchange Act of 1934 [15 U.S.C. 78n(d)(1) and 78*l*(g)(2)(B)].

to which the prospectus delivery requirements of Section 5 of the 1933 Act apply, shareholders to whom offers of exchange are made should be furnished, in the manner described above, with all material information relevant to their investment decisions, and be given appropriate time and means to communicate their decisions respecting such offers. Under such circumstances, the Commission will not object to offers of exchange being made effective pursuant to methods chosen by directors, provided that in each instance the boards of directors of the new fund and the existing fund determine that such procedures are fair and in the best interests of the shareholders of their respective funds. 17/

17/ If shares of the new fund are acquired by the existing fund pursuant to offers of exchange, the Commission will not view such acquisitions as violating the provisions of Section 12(d)(1) of the 1940 Act [15 U.S.C. 80a-12(d)(1)], provided that the shares so acquired are promptly redeemed. In this regard, the Commission intends to institute rulemaking proceedings to propose a temporary rule which may become effective on an emergency basis before July 28, 1980, immediately upon approval by the Commission, to exempt existing funds, whose fundamental policies may not permit the purchase of shares of other investment companies, from the provisions of Section 13(a) of the 1940 Act [15 U.S.C. 80a-13(a)] to the extent necessary to permit such purchases. In addition, the temporary rule would provide an exemption from the provisions of Section 12(d)(1) of the 1940 Act to permit the existing fund to hold shares of the new fund for not more than 120 days where no investment advisory fee, or fee for administrative services, is charged by the existing fund on account of the shares so held.

The Commission will not view the offer of exchange, or the liquidation of assets which will follow of necessity, as having the effect of changing the nature of the business of the new fund so as to cease being an investment company without shareholder approval as required by Section 13(a)(4) of the 1940 Act [15 U.S.C. 80a-13(a)(4)].

Many money market funds are utilizing amortized cost valuation or "penny rounding" pricing pursuant to orders of the Commission for purposes of pricing their shares for sales and redemptions. 18/ Such prices constitute "net asset value" for purposes of Section 11(a) of the 1940 Act. 19/ This practice is not inherently objectionable because the most basic assumption underlying the amortized cost and "penny rounding" pricing methods is that all securities purchased will be held to maturity by the investment company as a "going concern."

Nevertheless, under certain circumstances the use of exchange ratios reflecting relative net asset values based upon amortized cost prices or "penny rounded" prices of shares of the new fund and the existing fund could result in serious inequities due to the magnitude of the exchanges, and consequential redemptions, which may occur. For example, where at the time of exchange the unrounded market based

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18/ See, e.g., Investment Company Act Release Nos. 10451 and 10824 (dated October 26, 1978, and August 8, 1979, respectively).

19/ See Section 11(a)(B) of the 1940 Act.

net asset value per share of a new fund (less any reserve for liquidation and organization expenses) is less than the price per share of the new fund, the new fund would not in fact have sufficient assets to redeem all of its remaining shares at their amortized cost or "penny rounded" price. Such a result would be inequitable to remaining shareholders of the new fund. Similarly, a windfall gain could result to shareholders of the new fund remaining after the offer of exchange if the new fund's unrounded market based net asset value per share (less liquidation and organization expenses) at the time of exchange exceeds its amortized cost or "penny rounded" price per share. 20/ Accordingly, in the Commission's view, if offers of exchange are effected at relative net asset values per share calculated through the use of any method other than by reference to market factors (without rounding), boards of directors should, consistent with their fiduciary duties, give close and careful consideration to adopting the use of a market based net asset value per share before exchanges of shares are

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20/ Assuming directors have considered all other relevant factors, this latter result could be avoided through the declaration of a dividend prior to the exchange in an amount equal to the excess of market based net asset value per share (less amounts reserved) over the amortized cost price per share.

effected in order to insure that such exchanges are equitable to all shareholders of the funds involved. 21/

Finally, in considering the timing and appropriateness of offers of exchange, boards of directors of new funds should be cognizant of the fact that special deposits will not be refunded until August 11, 1980. Significant redemptions of new fund shares prior to that date, absent appropriate emergency arrangements, will have the effect of increasing the portion of a new fund's assets subject to the special deposit, and could impair the ability of a fund to continue to redeem its remaining shares. 22/

21/ In fact, boards of directors of funds operating pursuant to Commission orders permitting amortized cost valuation are required, pursuant to the conditions of such orders, to adjust exchange ratios to reduce to the extent reasonably practicable any unfair result or material dilution.

22/ To alleviate some of the problems that could arise if shareholders remain in new funds, directors may be asked to consider whether shareholders who remain in the new fund should be redeemed on an involuntary basis. In that regard, directors should consider carefully the factors addressed in Rule 13e-3 under the Securities Exchange Act of 1934 [17 CFR §240.13e-3]. The staff of the Commission has stated that it would not recommend action by the Commission if shares held by shareholders who have not accepted offers of exchange are involuntarily redeemed, provided the board of directors of the new fund concludes that such mandatory action is in the best interests of these shareholders. The offers of exchange in such cases should disclose fully the consequences of rejecting the exchange offer. Although, under most circumstances, effectuation of involuntary redemptions could be viewed as a violation of shareholders' fundamental rights to redeem shares, as assured by Section 22(e) of the 1940 Act, in this situation the need to assure the orderly suspension of the operations of new funds, in a manner that is not inequitable, could justify the use of this highly unusual measure.

This discussion is not intended to suggest that directors do not have the responsibility to consider and to determine whether other actions may not be equally appropriate.

2. Sales of Securities Between Funds.

Section 17(a) of the 1940 Act [15 U.S.C. 80a-17(a)], in pertinent part, generally prohibits an affiliated person of a registered investment company from purchasing securities from, or selling securities to, such registered investment company. Registered investment companies that are part of the same "complex" of investment companies are normally affiliated persons of each other. 23/ In such cases, securities held in the portfolio of the new fund could not be sold or otherwise transferred to the existing fund absent an exemption from the provisions of Section 17(a) of the 1940 Act. However, the most efficient and economical method of generating the necessary cash to meet the redemptions anticipated in new funds may be for the new fund to sell some or all of its assets to the existing fund.

23/ Section 2(a)(3)(C) of the 1940 Act [15 U.S.C. 80a-2(a)(3)(C)]. For purposes of Section 17(a) of the Act, each series of shares of a registered open-end investment company meeting the provisions of Section 18(f)(2) of the 1940 Act [15 U.S.C. 80a-18(f)(2)] should be deemed to be separate companies which are affiliated persons of each other. See Section 2(a)(8) of the 1940 Act [15 U.S.C. 80a-2(a)(8)].

The Commission intends to institute rulemaking proceedings permitting such transactions to be effected; it expects, before July 28, 1980, to propose a temporary rule which may become effective on an emergency basis, immediately upon approval by the Commission. It is expected that this rulemaking will require that the boards of directors of the companies involved find the transaction to be in the best interests of the respective affiliated companies, and find that the interests of the shareholders of the respective companies will not be diluted as a result of the transaction. The rule will require that all portfolio instruments of the new fund being sold to the existing fund be sold at market value (i.e., marked to market), regardless of whether the new fund previously has valued such instruments at amortized cost, but will permit the sale of individual instruments at their amortized cost values provided that in the aggregate the mark to market value of all such individual instruments being sold does not differ materially from the amortized cost value of such instruments. Solely for this purpose, the rule will deem a deviation of mark to market value from amortized cost value of less than 1/2 of 1 percent not to be material. 24/

24/ The rule will permit the sale of portfolio instruments of the new fund to the existing fund in several separate transactions. However, in such cases and in cases where all of the assets of the new fund are not sold, boards of directors of new funds will be required to consider certain factors in selecting those assets to be sold in order to protect the interests of shareholders remaining in the new funds.

The adoption of such a rule should enable new funds to generate sufficient cash, and existing funds to purchase assets, promptly and without some of the transactions costs normally associated with sales and purchases of portfolio securities.

OTHER MATTERS

Before revising any current policies presently restricting the sale of shares of an existing fund, the board of directors of the fund should give careful consideration to the potential impact of such policy revision upon existing shareholders of the fund. For example, if an existing fund previously has limited sales of its shares to existing accounts, the board of directors should consider whether elimination of that sales restriction at this time would result in substantial new sales of fund shares, requiring the fund to purchase debt securities bearing lower yields and thereby reducing significantly the dividends payable on existing shares of the fund. 25/ Although under ordinary circumstances the Commission would not expect money market funds to alter their sales policies merely because of declining interest rates, the extraordinary level of sales of shares of existing funds that may occur warrants directoral consideration of this issue.

25/ Of course, this possibility should also be considered before making any offer of exchange pursuant to Section 11(a) of the 1940 Act to shareholders of another money market fund.

In addition, where a new fund currently is relying upon temporary Rule 6c-4(T) and the board of directors of that new fund is considering whether to modify its investment objectives, its features or its services, the directors should recognize that such modifications may deprive the new fund of its ability to continue to rely upon the temporary rule. 26/ Such modifications could also eliminate the availability of the rule for use by other persons and companies associated or dealing with the new fund and now relying on the rule. 27/ On the other hand, the rescission of the Board's regulations will not be considered by the Commission as making a company or person ineligible to rely on Rule 6c-4(T) solely because of the rescission of the Board's regulations. Thus, paragraphs (a)(3)(ii) and (iii) of the rule, which, among other things, require that a fund relying upon the rule be a "covered creditor" under the Board's regulations, should be read for this purpose as though the Board's regulations remained in effect.

26/ Among other things, paragraph (a)(3) of Rule 6c-4(T) requires that the new fund provide essentially the same features and services as an "existing company," and have comparable policies and objectives, in order to qualify for the exemptions provided by the rule.

27/ Paragraph (c) of Rule 6c-4(T) extends certain exemptions to persons and companies associated with or transacting business with a new fund to enable certain relationships and transactions with respect to an existing fund to continue with the new fund. However, that exemptive relief is conditioned upon the new fund meeting the requirements set forth in paragraph (a)(3) of the rule.

The Commission expects to consider the continued appropriateness of Rule 6c-4(T) in the near future, as investment companies react to rescission of the credit control regulations. As stated in the release adopting the temporary rule on an emergency basis, after appropriate notice, the Commission may determine it to be appropriate to rescind the rule in whole or in part.

Finally, the Commission expects to consider in the near future whether Rule 24e-2 under the 1940 Act [17 CFR §270.24e-2] should be amended to mitigate duplication of registration fees.

CONCLUSION

The Commission has instructed its Division of Investment Management to monitor closely the manner in which money market funds address the matters discussed herein, and to advise the Commission with respect to its findings as developments may require.

Accordingly, 17 CFR Parts 231 and 271 are hereby amended to incorporate therein this general statement of policy.

By the Commission.

George A. Fitzsimmons
Secretary.

July 21, 1980.