SOME FACTORS WHICH MIGHT BE INCLUDED IN A MINIMAL CREDIT RISK DETERMINATION

The Release lists the following factors as examples of components of the credit risk evaluation.

- the issuer or guarantor's financial condition, *i.e.*, analysis of recent financial statements, including trends relating to cash flow, revenue, expenses, profitability, short-term and total debt service coverage, and leverage (including financial leverage and operating leverage).
- the issuer or guarantor's liquidity, including bank lines of credit and alternative sources of liquidity.
- the issuer or guarantor's ability to react to future events, including a discussion of a "worst case scenario," and its ability to repay debt in a highly adverse situation.
- the strength of the issuer or guarantor's industry within the economy and relative to economic trends as well as the issuer or guarantor's competitive position within its industry (including diversification in sources of profitability, if applicable).

The Release also states that the board's evaluation could include an analysis of whether the price and/or yield of a security is similar to that of other securities in the fund's portfolio.

The Release lists the following additional possible factors relating to municipal securities:[1]

- sources of repayment;
- issuer demographics (favorable or unfavorable), such as the type, size, diversity and growth or decline of the local government's tax base, including income levels of residents, and magnitude of economic activity;
- the issuer's autonomy in raising taxes and revenue;
- the issuer's reliance on outside revenue sources, such as revenue from a state or federal government entity; and
- the strength and stability of the supporting economy.

The Release lists the following additional possible factors relating to conduit securities:[2]

- analysis of the underlying obligor as described above for all securities except asset-backed securities (including asset-backed commercial paper).

The Release lists the following additional possible factors relating to asset-backed securities (including asset-backed commercial paper):[3]

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[1] The Municipal Securities Rulemaking Board defines municipal securities as "a general term referring to a bond, note, warrant, certificate of participation or other obligation issued by a state or local government or their agencies or authorities (such as cities, towns, villages, counties or special districts or authorities)."

[2] Under the Rule, a conduit security means a security issued by a municipal issuer involving an arrangement or agreement entered into, directly or indirectly, with a person other than a municipal issuer, which arrangement or agreement provides for or secures repayment of the security.

[3] Under the Rule, Asset Backed Security means a fixed income security (other than a Government Security) issued by a Special Purpose Entity, substantially all of the assets of which consist of Qualifying Assets. Special Purpose Entity means a trust, corporation, partnership or other entity organized for the sole purpose of issuing securities that entitle their holders to receive payments that depend primarily on the cash flow from Qualifying Assets, but does not include a registered investment company. Qualifying Assets means financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders.

- analysis of the underlying assets to ensure they are properly valued and that there is adequate coverage for the cash flows required to repay the asset-backed security under various market conditions;
- analysis of the terms of any liquidity or other support provided; and
- legal and structural analyses to determine that the particular asset-backed security involves no more than minimal credit risks for the fund.

The Release lists the following additional possible factors relating to other structured securities:[4]

- analysis of the issuer or obligor's financial condition, as described above; and
- analysis of the protections for the fund provided by the legal structure of the security.

The Release lists the following additional possible factors relating to repurchase agreements that are "collateralized fully":[5]

- an assessment of the creditworthiness of the counterparty, of the volatility and liquidity of the market for collateral, if the collateral is a government agency collateralized mortgage obligation or mortgage-backed security, or other non-standardized security; and the process for liquidating collateral.

The Release lists the following additional possible factors relating to repurchase agreements that are not fully collateralized:[6]

- a financial analysis and assessment of the minimal credit risk of the counterparty, as described above, without regard to the value of the collateral;
- consideration of the type of collateral accepted; and
- the ability of the fund to liquidate the collateral.

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4 Other structured securities listed in the Release include variable rate demand notes, tender option bonds, extendible bonds, "step up" securities, or other structures. The Release describes each of these types of securities. A variable rate demand obligation (which includes variable rate demand notes) is a security for which the interest rate resets on a periodic basis and holders are able to liquidate their security through a "put" or "tender" feature, at par. A tender bond option is an obligation that grants the bondholder the right to require the issuer or specified third party acting as agent for the issuer to purchase the bonds, usually at par, at a certain time or times prior to maturity upon the occurrence of specified events or conditions. An extendible bond is a long-term debt security with an embedded option for either the investor or the issuer to extend its maturity date. To qualify as an eligible security under the rule, the issuer must not have the right to extend the maturity of the bond so that it is more than 397 days to maturity at any time. A "step up" security pays an initial interest rate for the first period, and then a higher rate for the following periods.

5 The U.S. Commodity Futures Trading Commission defines a repurchase agreement as a "transaction in which one party sells a security to another party while agreeing to repurchase it from the counterparty at some date in the future, at an agreed price." Under the Rule, for a repurchase agreement to be "collateralized fully," the collateral must consist entirely of cash items or Government securities.

6 For a definition of a repurchase agreement, *see id.*