Asset-Specific Factors That Might Be Included in a Minimal Credit Risk Determination

The release adopting the amendments to Rule 2a-7 of the Investment Company Act of 1940, as amended, (Release) provides the following asset-specific factors that, to the extent applicable, fund advisers may wish to consider in making a minimal credit risk determination:

- For municipal securities:[1] (i) sources of repayment; (ii) issuer demographics (favorable or unfavorable);[2] (iii) the issuer's autonomy in raising taxes and revenue; (iv) the issuer's reliance on outside revenue sources, such as revenue from a state or federal government entity; and (v) the strength and stability of the supporting economy.[3]

- For conduit securities under Rule 2a-7:[4] analysis of the underlying obligor for all securities except asset-backed securities (including asset-backed commercial paper).[5]

- For asset-backed securities, such as asset-backed commercial paper:[6] (i) analysis of the terms of any liquidity or other support provided; and (ii) legal and structural analyses to determine that the particular asset-backed security involves no more than minimal credit risk for the money market fund.

- For other structured securities:[7] in addition to analysis of the issuer's or obligor's financial condition, analysis of the protections for the money market fund provided by the legal structure of the security.[8]

---

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 Demographics could include considerations 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.

3 Additional factors such as sources of repayment, autonomy in raising taxes and revenue, reliance on outside revenue sources, and strength and stability of the supporting economy should be considered with respect to tax-exempt securities. This may also include consideration of capacity to pay and assess operating and financial performance levels and trends.

4 Under Rule 2a-7, 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.

5 Factors for revenue bonds include consideration of the obligor's financial condition and reserve levels.

6 Under Rule 2a-7, an 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.

7 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.

- For repurchase agreements under Rule 2a-7:[9] a financial analysis and assessment of the minimal credit risk of the counterparty, an assessment as to whether the haircut level is appropriate for the particular type of collateral based upon price volatility in the market for such collateral type, and a legal analysis of the protections for the money market fund provided by the terms of the repurchase agreements.

---

8 This may also include evaluation and understanding of specific aspects of the legal structure, including loss allocation rules, potential impact of performance and market value triggers, support provided by credit and liquidity enhancements, and adequacy of structural subordination.

9 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."