Stricter New 2a-7 Rules for Money Market Funds

Summary of Key, New Provisions of 2a-7

- Improved Liquidity: The new rules require money market funds to have a minimum percentage of their assets in highly liquid securities so that those assets can be converted to cash to pay redeeming shareholders. Currently, there are no minimum liquidity mandates. All money market funds must have at least 30% of assets invested in cash equivalent securities with remaining maturities of 60 days or less, or securities that can be converted into cash within one week. *Source: SEC*

Expected Effect: Increased demand for shorter maturities/puts like weekly reset VRDBs

- Shorter Maturity Limits: The maximum weighted average maturity (WAM) will be reduced from 90 to 60 days and weighted average life (WAL) will be limited to 120 days or less (currently there is no WAL restriction). *Source: SEC*

Expected Effect: Increased demand for shorter maturities/puts like weekly reset VRDBs

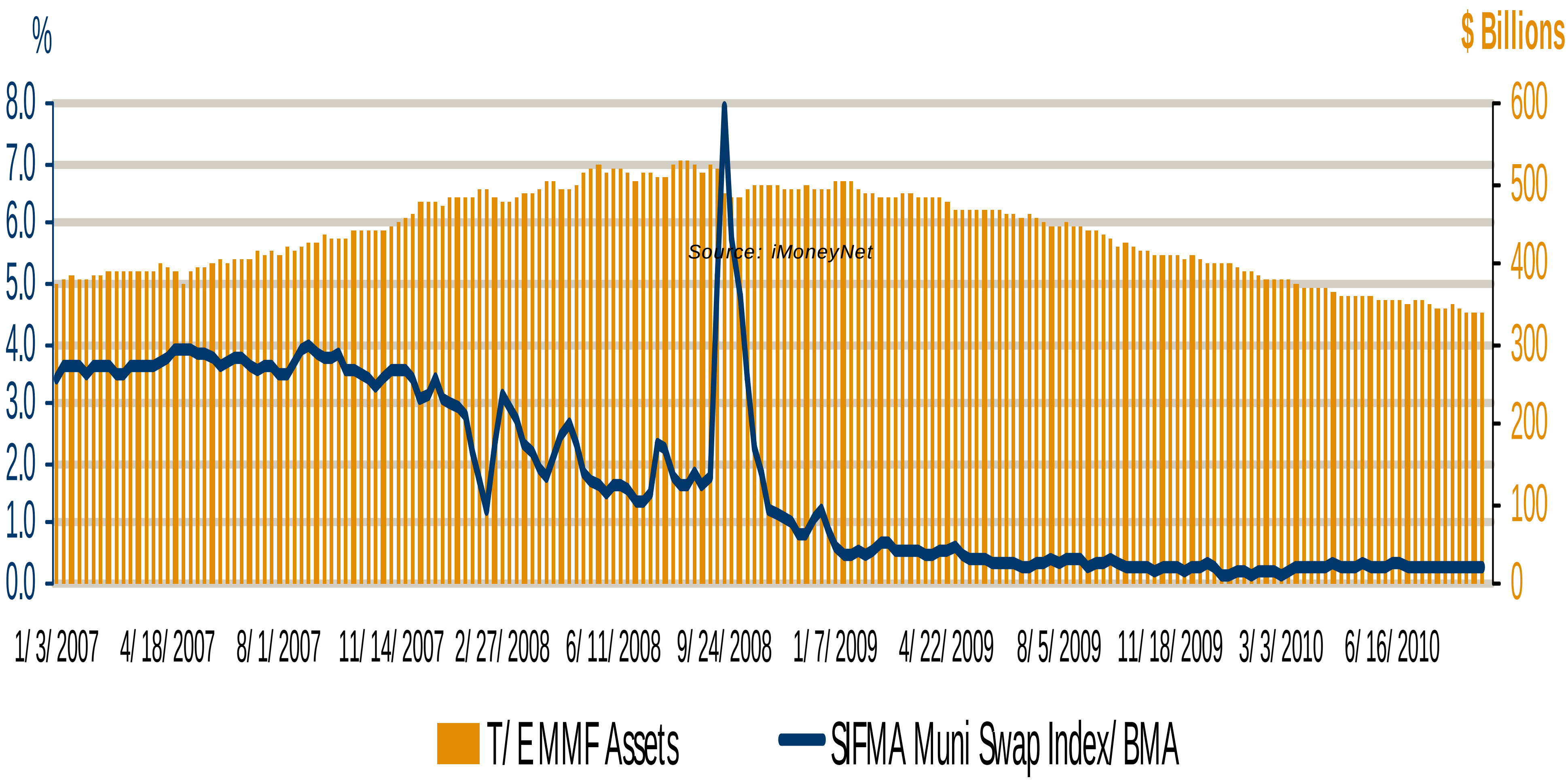
- Higher Credit Quality: Money market funds will be limited to no more than 3% of their holdings in tier-2 securities (rather than the current limit of 5%). Additionally, MMFs will be restricted from purchasing tier-2 securities that mature in more than 45 days (rather than the current limit of 397 days). *Source: SEC*

Expected Effect: Increased demand for shorter maturities/puts like weekly reset VRDBs

Most funds are already compliant with the new rules

Municipal Short Term Market

SIFMA Index vs. Tax-Exempt Money Market Fund Assets under Management



Municipal Short Term Market cont.

- Tax-exempt money market funds will conservatively manage themselves within the new 60 WAM restriction (current WAM of all MMFs is 32-days).
  - In order to achieve a 60-day WAM, you would need a sample portfolio of 85% (7-day) and 15% (1-year).
- As an example: The potential impact of a 40-day WAM target on the 1-year note market: 91% (7-day VRDB) and 9% (1-year note).
  - Total tax-exempt AUM/California MMFs as of 9/8/10: $338 billion/$38 billion x 15% = $50.7 billion/$5.7 billion.
  - Total tax-exempt AUM/California MMFs as of 9/9/09: $442 billion/$47 billion x 15% = $66.3 billion/$7.05 billion.
  - Total tax-exempt AUM/California MMFs as of 9/10/08: $524 billion/$72 billion x 15% = $78.6 billion/$10.8 billion.
- 1-year index notes can be accounted for as 7-day WAM and 365-day WAL, which may increase demand for indexed products by MMFs.
- As an example: The potential impact of an 80-day WAL target on the 1-year note market: 80% (7-day) and 20% (1-year).
  - Total tax-exempt AUM/California MMFs as of 9/8/10: $338 billion/$38 billion x 20% = $67.6 billion/$7.6 billion.
  - Total tax-exempt AUM/California MMFs as of 9/9/09: $442 billion/$47 billion x 20% = $88.4 billion/$9.4 billion.
  - Total tax-exempt AUM/California MMFs as of 9/10/08: $524 billion/$72 billion x 20% = $104.8 billion/$14.4 billion.

Factors Supporting Low SIFMA Index Resets

Supply-demand dynamics in the short term market remain balanced but fragile

SUPPLY	Effect
Bank facility fees remain relatively high while new banks and legacy banks have allocated additional capacity during 2010.	
Most 2010 issues coming to market are aimed at replacing existing liquidity providers and not new money issuance.	
State HFAs received $15 B in replacement LOCs from federal GSEs (government sponsored entities) and those fees step up 25 bps on 12/31/10 and an additional 25 bps on 12/31/11 until their expiration on 12/31/12.[1]	
Industry regulators and rating agency guidance is pointing toward more stringent management of put risk skewing fixed to variable debt mix more toward fixed rates.	
Basel III has the potential to dramatically increase the cost of bank facilities by imposing a liquidity coverage ratio of at least 100% on all lines of credit beginning in 2015.[2]	
Approximately $25 billion in LOCs are expiring in 2011 that are not expected to be renewed.	

DEMAND	Effect
Many corporate investors are buying VRDBs and tax-exempt notes with yields in excess of taxable levels. Ex. 1-year t-bills 0.25%; 1-year tax-exempt notes 0.46%.	
Excessively low yields have led to low demand from tax-exempt money funds. The average tax-exempt MMF yield has been around 4 bps for most of 2010.[3]	
Approved SEC money fund rule changes: WAM reduced to 60 days from 90 days; WAL introduced 120 day restriction; and tier-2 securities reduced to 3% of portfolio from 5%.[4]	
Some municipal bond funds have been buying VRDBs to boost liquidity and VRDB ETFs have over $1 billion in assets under mgt.	
Bank and insurer downgrades have led to replacement demand for well-structured variable rate demand bonds from MMFs.	

1. Source: Freddie Mac
2. Source: Bank for International Settlements
3. Source: iMoneyNet
4. Source: SEC

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