

## SEC Adopts Changes to Money Market Fund Regulations

Last year, the Securities and Exchange Commission (SEC) proposed a series of new rules and rule amendments for money market funds. At their open meeting in January 2010, the SEC voted 4-1 to adopt several of their proposals. On February 23, 2010, the final rule Release was posted in the Federal Register. The new rules and rule amendments are effective May 5, 2010, unless otherwise specified in the Release. The following chart summarizes the new and amended rules and their respective compliance dates.

According to the SEC, the amendments are designed to make money market funds more resilient to certain short-term market risks, and to provide greater protections for investors in a money market fund that is unable to maintain a stable net asset value per share.

While the adoption of these rules is a good first step to ensuring that money market funds continue to represent a safe, highly liquid option for investors of cash, more needs to be done, according to SEC Chairman Shapiro. The Release notes that the SEC is continuing to explore the possibility of more significant changes to the regulation of money market funds

“some of which could transform the business and regulatory model on which money market funds have been operating for more than 30 years.” A release addressing these issues and proposing further reform to money market fund regulation is forthcoming.

To date, the impact on the money market strategies employed by Western Asset has been limited. Western Asset has been adhering to the guidelines recommended by the ICI in early 2009. While the new SEC requirements are, overall, a bit more stringent, they are generally consistent with those proposed by the ICI.

The SEC amendments will likely result in a more competitive money market yield environment, as the portfolio management investment tools become more limited. We believe that Western Asset’s extensive experience in managing money market funds, in conjunction with our emphasis on credit research and risk management should enable us to continue to provide competitive returns to our investors as the regulatory landscape continues to evolve.

### Amendments to Rule 2a-7 for Money Market Funds

Category	Implementation date	Amended Rule	Current SEC Regulations
Maturity Limits	June 30, 2010	<ul style="list-style-type: none"> <li>Maximum weighted average maturity (WAM) is 60 days</li> <li>Maximum weighted average life (spread WAM) of 120 days</li> </ul>	<ul style="list-style-type: none"> <li>Maximum weighted average maturity (WAM) is 90 days</li> <li>No spread WAM requirement</li> </ul>
Liquidity	May 28, 2010	<ul style="list-style-type: none"> <li>All taxable money market funds must hold at least 10% of assets in “daily liquid assets”</li> <li>“Daily liquid assets” include cash (including demand deposits), Treasury securities, and securities (including repurchase agreements) for which a money market fund has a legal right to receive cash in one business day.</li> <li>All money market funds must hold at least 30% of assets in “weekly liquid assets”</li> <li>“Weekly liquid assets” include the same assets of “daily liquid assets” (except that the fund would have had to have the right to receive cash in five business days rather than one) plus agency notes that are issued at a discount to the principal amount to be repaid at maturity and have a remaining maturity of 60 days or less.</li> <li>Limit “illiquid” securities to 5% of a fund’s portfolio</li> <li>Define the term “illiquid security” as a security that cannot be sold or disposed of in the ordinary course of business within seven days at approximately the value ascribed to it by the fund</li> </ul>	<ul style="list-style-type: none"> <li>No liquidity requirement</li> <li>Limit “illiquid” securities to 10% of a fund’s portfolio</li> </ul>
Credit Quality	May 28, 2010	<ul style="list-style-type: none"> <li>Limit the purchase of Second Tier securities to 3% of fund’s assets</li> <li>Limit exposure to any single Second Tier Issuer to 0.5% of a fund’s assets</li> <li>Limit the maximum maturity of Second Tier securities to 45 days</li> </ul>	<ul style="list-style-type: none"> <li>Limit the purchase of Second Tier securities to 5% of fund’s assets</li> <li>Limit exposure to any single Second Tier Issuer to 1% of a fund’s assets or \$1 million</li> </ul>
	December 31, 2010	<ul style="list-style-type: none"> <li>Board of Directors of each fund must designate, at least annually, four (4) Nationally Recognized Statistical Rating Organizations (NRSROs) whose ratings the fund’s Board considers to be reliable</li> <li>Funds must identify the designated NRSROs in the funds statement of additional information</li> </ul>	<ul style="list-style-type: none"> <li>Maximum maturity of Second Tier securities is 397 days</li> <li>No ratings designation requirement</li> </ul>

## Amendments to Rule 2a-7 for Money Market Funds (Cont'd)

Category	Implementation date	Amended Rule	Current SEC Regulations
Repurchase Agreements	May 28, 2010	<ul style="list-style-type: none"> <li>If a fund "looks through" the repurchase agreement, collateral will be restricted to cash or government securities</li> <li>The fund's board of directors or its delegate must evaluate the creditworthiness of the repurchase agreement counterparty in order for the fund to take advantage of the special look-through treatment under rule 2a-7's diversification provisions.</li> </ul>	<ul style="list-style-type: none"> <li>If a fund "looks through" the repurchase agreement, collateral will be restricted to cash, government securities and highly-rated securities</li> <li>No counterparty creditworthiness requirement</li> </ul>
"Know Your Client"	May 5, 2010	<ul style="list-style-type: none"> <li>Funds must adopt procedures to identify investors whose redemption requests may pose a risk for funds and therefore hold sufficient amounts of liquid securities to meet redemptions</li> <li>Funds may seek access to information about the investors who hold their interests through omnibus accounts in addition to considering information about the omnibus accounts, including their aggregate historical redemption patterns and the account record holder's ability to redeem the entire account</li> </ul>	<ul style="list-style-type: none"> <li>No "Know Your Client" requirement</li> </ul>
Disclosure	October 7, 2010  December 7, 2010	<ul style="list-style-type: none"> <li>Monthly website postings of the following with respect to each security held: name of the issuer, category of investment, CUSIP number, principal amount, maturity date as determined under rule 2a-7 for purposes of calculating WAM, the final maturity date, if different from the maturity date previously described, coupon or yield and the amortized cost value. In addition, funds will be required to disclose their WAM and spread WAM.</li> <li>Funds must post the portfolio information, current as of the last business day of the previous month, on its website, no later than the fifth business day of the month.</li> <li>Portfolio information must be maintained in the fund's website for no less than six months after posting.</li> <li>Monthly reporting to the SEC on new form N-MFP within five business days after the end of each month.</li> <li>Information included on Form N-MFP with respect to each portfolio security held on the last business day of the prior month include the following: name of issuer, title of the issuer, including the coupon or yield, CUSIP number, category of investment, the NRSRO designated by the fund, the credit ratings given by each NRSRO, and whether the security is first tier, second tier, unrated, or no longer eligible, the maturity date as determined under rule 2a-7, taking into account the maturity shortening provisions of rule 2a-7, the final legal maturity, taking into account any maturity date extensions that may be effected at the option of the issuer, whether the instrument has certain enhancement features, the principal amount, the current amortized cost value, the percentage of the funds assets invested in the security, whether the security is an illiquid security and explanatory notes. The dollar weighted average maturity of the fund's portfolio and its seven day-gross yield must be included. In addition, the fund must report on Form N-MFP the market-based values of each portfolio security and the fund's market-based NAV, with separate entries for values that do and do not take into account any capital support agreements into which the fund may have entered.</li> <li>This information would be available to the public on a 60-day delay</li> </ul>	<ul style="list-style-type: none"> <li>No disclosure requirement</li> <li>A fund's "shadow" NAV is reported to the SEC semi-annually, with a 60-day delay</li> </ul>
Stress Testing	May 5, 2010	<ul style="list-style-type: none"> <li>Require funds to examine each month its ability to maintain a stable NAV in the event of shocks. These include an increase in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on portfolio securities, and widening or narrowing of spreads between yields on an appropriate benchmark selected by the fund for overnight interest rates and commercial paper and other types of securities held by the fund.</li> <li>Report must include the dates on which the fund portfolio was tested and the magnitude of each hypothetical event that would cause the fund to break the buck. It must also include an assessment by the fund's advisor of the fund's ability to withstand the events that are reasonably likely to occur within the following year.</li> <li>Requires that the board receive a report of the results of the stress testing at its next regularly scheduled meeting, and more frequently, if appropriate, in light of the results.</li> <li>Funds must maintain records of the stress testing for six years, the first two in an easily accessible place.</li> </ul>	<ul style="list-style-type: none"> <li>No stress test requirement</li> </ul>
Operations	October 31, 2011  May 5, 2010	<ul style="list-style-type: none"> <li>All funds or its transfer agent must have the capacity to electronically redeem and sell its securities at a price based on the fund's current NAV, including the capacity to sell and redeem shares at prices that do not correspond to the stable NAV.</li> <li>Adoption of new rule 22e-3. The rule permits a fund to suspend redemptions and payment of redemption proceeds if the fund's board, including a majority of disinterested directors, determines that the deviation between the fund's amortized cost price per share and the market-based NAV may result in material dilution or other unfair results, the board, including a majority of disinterested directors, irrevocably has approved the liquidation of the fund, and the fund, prior to suspending redemptions, notifies the Commission of its decision to liquidate and suspend redemptions.</li> </ul>	<ul style="list-style-type: none"> <li>No processing requirement</li> <li>Board must submit an order to the SEC to suspend redemptions</li> </ul>

## Amendments to Rule 2a-7 for Money Market Funds (Cont'd)

Category	Implementation date	Amended Rule	Current SEC Regulations
Affiliate Support	May 5, 2010	<ul style="list-style-type: none"> <li>Amend rule 17a-9 under the Investment Company Act to expand the ability of affiliates of money market funds to purchase assets from funds in order to protect a fund from losses.</li> <li>A "claw back" requirement has been added to eliminate incentives for fund advisors and other affiliates to buy securities for reasons other than protecting fund shareholders from potential future loss.</li> <li>Prompt electronic mail SEC notification is required if action taken, including the reasons for the purchase and the price at which the transaction was conducted.</li> </ul>	<ul style="list-style-type: none"> <li>An affiliate may purchase securities from the fund after a ratings downgrade or default, with SEC approval</li> </ul>
Asset Backed Securities	May 28, 2010	<ul style="list-style-type: none"> <li>Eliminate the requirement that asset backed securities be rated by at least one NRSRO in order to be an eligible security for money market funds.</li> <li>Part of the minimal credit risk analysis should include the following: analyze the underlying ABS assets to ensure that they are properly valued and provide adequate asset coverage for the cash flows required to fund the ABS under various market conditions, analyze the terms of any liquidity or other support provided by the sponsor of the ABS and otherwise perform the legal, structural, and credit analysis required to determine that the particular ABS involves appropriate risks for the money market fund</li> </ul>	<ul style="list-style-type: none"> <li>Asset backed securities must be rated by at least one NRSRO</li> </ul>

Source: Securities and Exchange Commission Rule Release <<http://www.sec.gov/rules/final/2010/ic-29132.pdf>> and Rule 2a-7 Investment Company Act

**Please note that an investment in a money market fund is neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the fund.**

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