

7 under the Act ("Money Market Funds").²

2. Some Funds may lend money to banks or other entities by entering into repurchase agreements or purchasing other short-term instruments. Other Funds may borrow money from the same or other banks for temporary purposes to satisfy redemption requests or to cover unanticipated cash shortfalls such as trade "fails" in which cash payment for a portfolio security sold by a Fund has been delayed.

3. If the Funds were to borrow money from a bank, the Funds would pay interest on the borrowed cash at a rate that would be significantly higher than the rate that would be earned by other (non-borrowing) Funds on repurchase agreements and other short-term instruments of the same maturity as the bank loan. Applicants state that this differential represents the profit the banks would earn for serving as a middleman between a borrower and a lender. In addition, while bank borrowings generally could supply needed cash to cover unanticipated redemptions and sales fails, the borrowing Funds would incur commitment fees and/or other charges involved in obtaining a bank loan.

4. Applicants request an order that would permit the Funds to enter into lending agreements ("Interfund Lending Agreements") under which the Funds would lend and borrow money for temporary purposes directly to and from each other through a credit facility ("Interfund Loan"). Applicants state that the proposed credit facility would reduce potential borrowing Funds' costs and enhance lending Funds' ability to earn higher rates of interest on short-term loans. Although the proposed credit facility would reduce the Funds' need to borrow from banks, the Funds would be free to establish lines of credit or other borrowing arrangements with banks.

5. Applicants anticipate that the credit facility would provide borrowing Funds with significant savings when the cash position of the Funds is insufficient to meet temporary cash requirements. This situation could arise when redemptions exceed anticipated volumes and the Funds have insufficient cash on hand to satisfy such redemptions. When the Funds liquidate portfolio securities to meet redemption requests, which are normally effected promptly upon receipt, they often do not receive payment in settlement of the liquidation for up to three days (or longer for certain foreign transactions).

The credit facility would provide a source of immediate, short-term liquidity pending settlement of the sale of portfolio securities.

6. Applicants also propose using the credit facility when a sale of securities fails due to circumstances beyond a Fund's control, such as delay in the delivery of cash to the Fund's custodian or improper delivery instructions by the broker effecting the transaction. Sales fails may present a cash shortfall if the Fund has undertaken to purchase a security with the proceeds from securities sold. Under such circumstances, the Fund could fail on its intended purchase due to lack of funds from the previous sale, resulting in additional cost to the Fund, or sell a security on a same day settlement basis, earning a lower return on the investment. Use of the credit facility would enable the Funds to have access to immediate short-term liquidity without incurring custodian overdraft or other charges or lower investment returns.

7. While borrowing arrangements with banks may be available to cover unanticipated redemptions and sales fails, under the proposed credit facility, a borrowing Fund would pay lower interest rates than those offered by banks on short-term loans. In addition, Funds making short-term cash loans directly to other Funds would earn interest at a rate higher than they otherwise could obtain from investing their cash in repurchase agreements or purchasing shares of a Money Market Fund. Thus, applicants believe that the proposed credit facility would benefit both borrowing and lending Funds.

8. The interest rate charged to the Funds on any Interfund Loan (the "Interfund Loan Rate") would be the average of the "Repo Rate" and the "Bank Loan Rate", both as defined below. The Repo Rate on any day would be the highest rate available to a lending Fund from investments in overnight repurchase agreements. The Bank Loan Rate on any day would be calculated by the Credit Facility Team, as defined below, each day an Interfund Loan is made according to a formula established by each Fund's board of trustees (each, a "Board"), intended to approximate the lowest interest rate at which a bank short-term loan would be available to the Fund. The formula would be based on a publicly available rate (e.g., Federal funds plus 25 basis points) that would vary so as to reflect changing bank loan rates. The Board of each Fund periodically would review the continuing appropriateness of using the publicly available rate, as well as the relationship between the Bank Loan

Rate and current bank loan rates that would be available to the Funds. The initial formula and any subsequent modifications to it would be subject to the approval of the Board of each Fund.

9. The credit facility would be administered by an AIA investment professional (namely, a portfolio manager for the Money Market Funds), representatives of Allfirst Trust and of ARK Funds' accounting group (collectively, the "Credit Facility Team"). Under the proposed credit facility, the portfolio managers for each participating Fund could provide standing instructions to participate daily as a borrower or lender. On each business day Allfirst Trust, as the Funds' custodian, would provide the Credit Facility Team with data on the uninvested cash and borrowing requirements of all participating Funds. Applicants expect far more available uninvested cash each day than borrowing demand. Once the Credit Facility Team determined the aggregate amount of cash available for loans and borrowing demand, the Credit Facility Team would allocate loans among borrowing Funds without any further communication from portfolio managers (other than the portfolio manager on the Credit Facility Team). All allocations would require approval of at least one member of the Credit Facility Team other than the Money Market Fund portfolio manager. After allocating cash for Interfund Loans, the Credit Facility Team would invest any remaining cash in accordance with the standing instructions from portfolio managers or return remaining amounts to the Funds. The Money Market Funds would not participate as borrowers.

10. The Credit Facility Team would allocate borrowing demand and cash available for lending among the Funds on what the Credit Facility Teams believes to be an equitable basis, subject to certain administrative procedures applicable to all Funds, such as the time of filing requests to participate, minimum loan lot sizes, and the need to minimize the number of transactions and associated administrative costs. To reduce transaction costs, each Interfund Loan normally would be allocated in a manner intended to minimize the number of participants necessary to complete the transaction.

11. The Credit Facility Team would (a) monitor the interest rates charged and the other terms and conditions of the loans, (b) limit the borrowings and loans entered into by each Fund to ensure that they comply with the Fund's investment policies and limitations, (c) ensure equitable treatment of each Fund, and (d) make quarterly reports to

² ARK Funds, *et al.* ICA Rel. Nos. 25136 (Aug. 24, 2001) (notice) and 25163 (Sept. 19, 2001) (order).