

MEMO# 1534

November 10, 1989

INSTITUTE LETTER TO SEC STAFF CONCERNING REGULATION OF MONEY MARKET FUNDS

November 10, 1989 TO: BOARD OF GOVERNORS NO. 70-89 SEC RULES COMMITTEE NO. 70-89 MONEY MARKET FUND CHIEF EXECUTIVE OFFICERS NO. 9-89 RE: INSTITUTE LETTER TO SEC STAFF CONCERNING REGULATION OF MONEY MARKET FUNDS

Attached is a copy of the letter the Institute submitted to the SEC staff concerning the quality standards applicable to instruments held by money market funds. As you know, this past summer an issuer defaulted on its short-term commercial paper which was held by a number of money market funds. Shortly thereafter, the staff of the SEC requested that the industry review the current regulation of money market funds. Specifically, the staff sought input on whether steps should be taken to tighten up Rule 2a-7, the rule governing the use of amortized cost valuation by money market funds. The Institute formed an ad hoc committee to review this matter. As stated in the letter, the committee concluded that it was not desirable to amend the provisions of Rule 2a-7. Instead, the committee suggested that the Commission issue an interpretive release reiterating the obligation of the fund to analyze and monitor credit risk, as currently required by the rule. In connection with considering credit risk, the letter notes that it would be useful if the release included factors that might be considered in assessing credit risk. As one of the factors, we recommended that with respect to money market instruments which have not received a rating higher than the second highest rating (e.g., A-2 or P-2), the quality of the issuer's senior, unsecured, long-term debt securities also be examined. If any of those long-term debt securities have received a rating below "investment grade," we stated that the release might suggest that the board consider limiting the fund's investments in that issuer's short-term debt to one percent of the fund's assets. In addition, the letter recommends that the Guidelines to Form N-1A be amended to require (1) certain disclosures concerning the credit analysis undertaken by the fund and (2) that funds which purchase certain instruments be required to disclose this fact in their prospectuses along with any associated risks. We will keep you informed of developments. Amy B. Rosenblum Assistant General Counsel Attachment