MEMO# 2210

September 24, 1990

INSTITUTE COMMENTS ON SEC PROPOSED REVISIONS TO MONEY MARKET FUNDS

September 24, 1990 TO: BOARD OF GOVERNORS NO. 69-90 MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 13-90 SEC RULES MEMBERS NO. 67-90 PUBLIC INFORMATION COMMITTEE NO. 34-90 MONEY MARKET FUND AD HOC COMMITTEE RE: INSTITUTE COMMENTS ON SEC PROPOSED REVISIONS TO MONEY MARKET FUNDS ____ As we previously informed you, the SEC has proposed changes to Rule 2a-7, the rule permitting money market funds to use amortized cost valuation and penny rounding pricing methods, and to other rules affecting money market funds. (See Memorandum to Board of Governors No. 50-90, Money Market Members - One Per Complex No. 9-90, SEC Rules Members No. 51-90 and Public Information Committee No. 22-90, dated July 20, 1990.) Attached is a copy of the Institute's comment letter on the SEC's proposed revisions to the rules regulating money market funds. Our comments, which were developed with the assistance of the Institute's Money Market Fund Ad Hoc Committee, focus only on taxable money market funds. We are still considering proposals for tax-exempt funds. In the meantime, we supported the SEC's proposal to apply the same maturity requirements to tax-exempt funds as taxable funds, but to exempt tax-exempt funds from any modified diversification and quality requirements. Set forth below is a summary of the Institute's comments. Proposed Changes to Rule 2a-7 a. Diversification - The Institute supported the SEC's proposal to require that a fund invest no more than 5% of fund assets in any one issuer (except U.S. government securities or repurchase agreements backed by U.S. government securities). b. Quality - The Institute opposed the proposed change to require that a security be rated eligible quality by all NRSROs that have rated the security. Instead, we recommended that if a security has been rated by only one rating agency that it be rated eligible quality by that agency and, if rated by more than one agency, it receive an eligible quality rating from at least two agencies. We opposed the proposal to allow funds to invest up to five percent of their assets in securities that have not received the highest rating (e.g., securities rated below A-1, P-1). We believe that such securities may present risks that are inappropriate for a fund seeking to maintain a stable net asset value. We noted in our letter that our opposition to this proposal was not intended to suggest that such investments were inappropriate for other types of mutual funds and financial intermediaries that do not seek to maintain a stable net asset value. Instead of allowing funds to invest in securities that have not received the highest rating as proposed by the SEC, we recommended that funds be permitted to invest up to ten percent of their assets (subject to a three percent per issuer limitation) in securities that have received a split-rating where at least one of the ratings is the highest (e.g., A-1/P-2). c. Maturity - The Institute supported the proposed amendment to reduce the dollar-weighted average portfolio maturity from 120 to 90 days. However, we opposed the proposal to extend the maturity limit of a single instrument from one to two years. Instead, we recommended that the maturity limit be thirteen months. d. Unrated Securities - The Institute recommended a more restrictive standard with respect to unrated securities than proposed by the SEC. We recommended that funds be permitted to invest in unrated securities only if they are of comparable quality to other outstanding short-term debt of the issuer that has received the highest rating or, if the issuer does not have other rated outstanding short-term debt, the long-term debt of the issuer that has received one of the three highest ratings. e. Holding Out - The Institute endorsed the proposal to require any fund that holds itself out as a "money market fund" to meet the quality, diversification and maturity requirements under Rule 2a-7. Prospectus Disclosure The Institute supported the SEC's proposal to require disclosure on the cover page of the prospectus that the shares of a money market fund are neither insured nor guaranteed by the U.S. government and that there is no assurance that the fund will be able to maintain a stable net asset value. May 8th Credit Letter The Institute requested clarification that the elements listed in the letter from the Division of Investment Management to money market funds on credit analysis are factors that could be considered, but are not required to be considered, by the board of directors. * * * The Institute would appreciate receiving copies of any comment letters filed by members. Please send any copies to Michele Dugue at the Institute. We will keep you informed of developments. Amy B. Rosenblum Assistant General Counsel Attachment