The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 5971

June 16, 1994

CONGRESSMEN MARKEY AND FIELDS REQUEST SEC STUDY ON MUTUAL FUNDS' USE OF DERIVATIVES

June 16, 1994 TO: BOARD OF GOVERNORS NO. 51-94 SEC RULES COMMITTEE NO. 65-94 RE: CONGRESSMEN MARKEY AND FIELDS REQUEST SEC STUDY ON MUTUAL FUNDS' USE OF DERIVATIVES ____ The Chairman of the House Subcommittee on Telecommunications and Finance, Edward J. Markey, and the ranking Republican member of the Subcommittee, Jack Fields, have issued a request that the Securities and Exchange Commission undertake a comprehensive study of the use of derivatives by mutual funds and the adequacy of laws and regulations governing their disclosure and use. The details of the request are set forth in a letter dated June 15, 1994 to SEC Chairman Arthur Levitt, a copy of which is attached. The letter expresses the view that the study is warranted because of "a small but growing number of reports of substantial losses apparently attributable to derivatives holdings at certain mutual funds." It notes that these funds included short-term government bond and money market funds, which many individuals view as "cautious and conservative (although obviously not risk-free) investments." The letter indicates that the study, a report on which is to be completed by July 18, should "address every issue related to the use of derivatives by mutual funds that the SEC deems to be important to its mission of protecting investors and promoting the integrity and health of the industry." In addition, it requests responses to the following specific questions: (1) Does the SEC have adequate knowledge of industry practices? (2) Better disclosure may be critical to help the SEC, but will it be accomplished in a manner that makes a significant difference to average investors? (3) Is intense competition in the fund industry (or any other reason) leading some portfolio managers to move risky derivatives into otherwise risk averse funds? (4) Are mutual funds experiencing problems pricing exotic derivatives? (5) Are mutual funds experiencing liquidity problems because of exotic derivatives? (6) Does the use of derivatives permit mutual funds to avoid limitations on the use of leverage mandated by the Investment Company Act of 1940? (7) Do the recent capital infusions by two fund complexes indicate that bank mutual fund investors may be facing special undisclosed risks? The letter also requests an update on the SEC's current views about the appropriateness of derivatives for money market fund portfolios. We will keep you advised of developments. * * * As you may know, pursuant to the recommendation of the Institute's Investment Issues Committee, the Institute is in the process of preparing a memorandum to provide guidance to fund directors and senior management of investment advisers on issues relating to fund investments in derivatives. The memorandum includes general descriptions of different types of derivative instruments, identifies regulatory and other issues concerning fund investments in derivatives and highlights possible areas for inquiry by fund directors. The final memorandum will be distributed to Institute members within the next few weeks. Matthew P. Fink President Attachment