INVESTMENT COMPANY INSTITUTE

The Asset Management Industry
SERVING INDIVIDUAL INVESTORS

MEMO# 4877

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CLARIFICATION OF SEC STAFF'S POSITION ON CAPPED FLOATERS UNDER RULE 2A-7

June 17, 1993 TO: MONEY MARKET FUNDS AD HOC COMMITTEE NO. 5-93 SEC RULES MEMBERS NO. 52-93 RE: CLARIFICATION OF SEC STAFF'S POSITION ON CAPPED FLOATERS UNDER RULE 2a-7 ____ The SEC Division of Investment Management issued the attached letter clarifying its position on the ability of money market funds to acquire certain capped floating and variable rate government securities under Rule 2a-7 of the Investment Company Act of 1940. Paragraph (c)(2)(i) of Rule 2a-7, with limited exceptions, prohibits money market funds from holding portfolio instruments having maturities greater than 397 days. Paragraph (d)(1) of the Rule permits funds to measure the maturity of a variable rate instrument issued or guaranteed by the United States government (or agency thereof) by reference to the period remaining until the next interest rate adjustment. In the letter, the staff reiterated its position that although paragraph (d)(1) does not explicitly provide that the instruments covered by that paragraph must have a market value that approximates their par value upon their interest rate readjustment, such a requirement is implicit in the Rule. With respect to the eligibility of capped floating or variable rate instruments under Rule 2a-7, the staff has taken the position that generally such instruments are inconsistent with the requirement that they can reasonably be expected to return to par upon readjustment. However, the staff would not object if, in the current interest rate environment, money market funds purchase variable or floating rate instruments issued by the United States government or an agency thereof the interest rates of which are capped at a rate in excess of 20% to comply with certain state usury laws in reliance on paragraph (d)(1) of the Rule. The letter states that this exception would not relieve money market funds from the overall duty of care to manage the fund in such a manner as to stabilize the fund's net asset value. The staff's position expressed in the letter does not limit the ability of money market funds to invest in capped instruments with final maturities of less than 397 days. The maturity of these instruments generally must be determined by reference to their final maturity rather than their interest rate readjustment date. However, consistent with the staff's position above, the maturity of floating or variable rate instruments issued by the United States government or an agency thereof with an interest rate cap in excess of 20% to comply with certain state usury laws which have less than 397 days remaining until final maturity may be determined based on their interest rate readjustment date. The staff's position also does not affect the ability of money market funds to invest in capped floating or variable rate demand notes or other instruments the maturity of which is determined by reference to a demand feature under paragraph (d)(3) or (4) of Rule 2a-7, because a fund may exercise the demand feature and receive the amortized value of the instrument in the event that interest rates rise so that the market value is below the par value of the instrument as a result of the cap. Amy B.R. Lancellotta Associate Counsel Attachment

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