The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 5854

May 6, 1994

INSTITUTE LETTER ON PROPOSED AMENDMENTS TO MONEY MARKET FUND REGULATION

May 6, 1994 TO: BOARD OF GOVERNORS NO. 38-94 MONEY MARKET FUNDS AD HOC COMMITTEE NO. 12-94 MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 3-94 SEC RULES COMMITTEE NO. 52-94 RE: INSTITUTE LETTER ON PROPOSED AMENDMENTS TO MONEY MARKET FUND REGULATION _____ As we previously informed you, the Securities and Exchange Commission has proposed amendments to Rule 2a-7 under the Investment Company Act, and other rules and forms under the Investment Company Act and the Securities Act of 1933 relating to the regulation of money market funds. (See Memorandum to Board of Governors No. 115-93, Money Market Members - One Per Complex No. 11-93, dated December 27, 1993, and Memorandum to SEC Rules Committee No. 113-94 and Money Market Funds Ad Hoc Committee No. 10-93, dated December 23, 1993.) The Institute submitted the attached comment letter on the proposed amendments. The significant aspects of the Institute's letter are summarized below. A. Tax-Exempt Money Market Funds 1. Diversification - The Institute's letter expressed support for the proposed diversification requirements for tax-exempt money market funds. These would require national funds to meet the five percent diversification requirement currently applicable to taxable funds and would exempt single state funds from this requirement. 2. Credit Quality - The Institute opposed the proposal to limit eligible securities for single state funds to first tier securities. We recommended that national and single state funds be subject to the same credit limitations. Specifically, we recommended that all tax-exempt funds be subject to a five percent limit on fund investments in second tier securities that are not traditional municipal obligations (i.e., "conduit securities", which is defined in the proposed amendments), and that single state funds be subject to a five percent issuer diversification requirement with respect to their investments in second tier traditional municipal obligations (i.e., non-conduit securities). As a fallback to our recommendation, we suggested that national and single state funds be subject to a twenty-five percent limit on investments in second tier municipal securities, of which no more than five percent could be invested in second tier conduit securities. B. Puts and Demand Features The Commission proposed amendments to and solicited comment on a number of issues relating to the treatment of puts and guarantees under Rule 2a-7. The Institute supported the proposed ten percent aggregate limit on a fund's investments in securities subject to puts from a single provider. We opposed, however, eliminating entirely the twenty-five percent undiversified put basket, which is currently available for tax-exempt funds. Instead, we recommended that the basket be retained for securities subject to puts issued by institutions determined to be of first tier quality under the Rule. We also opposed any limitation on a fund's ability to rely on non-bank put providers. Finally, we supported

the Commission's objective in proposing to restrict the types of conditions to which a put may be subject when used to shorten maturity, but suggested that more general language be adopted with respect to the types of conditions that would be permissible. C. Asset-Backed Securities The Institute generally opposed all of the amendments relating to asset-backed securities. We expressed the view that these instruments should be treated the same as all other instruments under Rule 2a-7. D. Disclosure Requirements The Institute supported, subject to slight modification, requiring that single state funds disclose in their prospectuses the risks related to the geographic concentration and, if applicable, the lack of diversification of their ivestments. E. Proposed Rule 17a-9 The Institute opposed proposed Rule 17a-9 under the Investment Company Act, which would permit a person affiliated with a money market fund to purchase a portfolio security from the fund in certain instances (such as when a security is in default) without having to obtain exemptive relief under Section 17(a) of the Act. We expressed the view that such an exemption from Section 17(a) could mislead investors by suggesting that the fund's adviser or other affiliate will "backstop" the fund, and therefore, that the fund's net asset value will always remain stable. Amy B.R. Lancellotta Associate Counsel Attachment

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