MEMO# 10212

August 19, 1998

SEC NO-ACTION LETTER ON TREATMENT OF CERTAIN VARIABLE RATE SECURITIES UNDER RULE 2A-7

1 Goldman Sachs & Co., SEC No-Action Letter (Aug. 14, 1998). 2 The amendments superseded a previous no-action letter, Merrill Lynch, Pierce, Fenner & Smith, SEC No-Action Letter (Apr. 6, 1987), in which the staff concluded that, subject to certain conditions, a money market fund could treat a variable rate security with a one-year stated maturity that automatically would extend by one interest rate period, unless the holder elected to terminate the automatic extension period, as having a maturity equal to its one-year stated maturity, as automatically extended. Here, it was asserted that the Notes are distinguishable from the notes considered in the Merrill Lynch letter because their maturity will not extend automatically if a holder fails to act. Thus, a fund holding the Notes must act affirmatively to elect to [10212] August 19, 1998 TO: MONEY MARKET FUNDS ADVISORY COMMITTEE No. 5-98 SEC RULES MEMBERS No. 63-98 RE: SEC NO-ACTION LETTER ON TREATMENT OF CERTAIN VARIABLE RATE SECURITIES UNDER RULE 2a-7 ____ The Division of Investment Management recently issued a no-action letter permitting a money market fund, that elects to extend the maturity of a variable rate security to a date no more than thirteen months from the election date, to treat the security as a "short-term variable rate security" for purposes of Rule 2a-7 under the Investment Company Act of 1940, even though the extended maturity date is more than 397 calendar days from the date the fund acquired the security.1 The staff's letter is summarized below and a copy is attached. No-action relief was requested by a securities firm that designed for investment by money market funds certain variable rate notes (the "Notes"), which have a stated maturity of thirteen months and do not have a demand feature. On a designated day each month after the Notes have been issued, a holder may elect to extend a Note's maturity to a date that is thirteen months after the date of election. If a holder does not affirmatively elect to extend a Note's maturity, its final maturity becomes the original, or previously extended, maturity date and its maturity thereafter cannot be extended in any future month. The interest rate on the Notes will readjust on a quarterly basis. Under Rule 2a-7, a money market fund may treat a "short-term variable rate security" (i.e., a variable rate security the principal amount of which must unconditionally be paid in 397 days or less) as maturing on the earlier of the date the interest rate readjusts or the date principal may be recovered upon demand. In contrast, a "long-term variable rate security" (i.e., a variable rate security the principal amount of which is scheduled to be paid in more than 397 days) may be treated as maturing on the later of the interest rate readjustment date or the date principal may be recovered upon demand. Rule 2a-7, as recently amended, now requires that maturity be measured by reference to the date on which a holder is "unconditionally"

entitled to principal. The Commission stated, when adopting the recent amendments to Rule 2a-7, that an unconditional right to receive principal exists when the issuer is obligated to pay without the performance of additional affirmative acts by the holder, other than physically delivering securities to the issuer for redemption.2 extend maturity each month. The staff concluded that because the Notes when initially acquired will unconditionally repay principal to the holder in no more than 397 days, and because each extension thereof can be for a period no greater than 397 days from the election date, the Notes always would have a remaining maturity of 397 calendar days or less. Thus, the Notes would be “short-term variable securities” for purposes of Rule 2a-7. The staff’s letter notes that under the firm’s proposal, funds relying on this no-action position would treat each extension as a separate “acquisition” under Rule 2a-7, requiring funds to comply with all applicable provisions of the rule. The letter also states that funds could treat the Notes as short-term variable rate securities only if, upon each interest rate readjustment, the Notes reasonably can be expected to have a market value that approximates their amortized cost value. Amy B.R. Lancellotta Senior Counsel Attachment