

MEMO# 2050

July 20, 1990

SEC PROPOSES CHANGES TO MONEY MARKET FUND REGULATION

July 20, 1990 TO: BOARD OF GOVERNORS NO. 50-90 MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 9-90 SEC RULES MEMBERS NO. 51-90 PUBLIC INFORMATION COMMITTEE NO. 22-90 RE: SEC PROPOSES CHANGES TO MONEY MARKET FUND REGULATION

The SEC has proposed for public comment a number of changes to Rule 2a-7, the rule permitting money market funds to use amortized cost valuation and penny-rounding price methods, to reduce the likelihood that a money market fund would not be able to maintain a stable net asset value. In addition, the SEC has proposed to require all funds that hold themselves out as "money market funds" to comply with certain requirements contained in Rule 2a-7 and to revise the definition of a "money market fund" under the advertising rules. Attached is a copy of the SEC's release proposing these changes. Proposed Changes to Rule 2a-7 The significant changes to Rule 2a-7 proposed by the SEC are as follows: a. Diversification i. Funds could not invest more than 5% of fund assets in any one issuer (except U.S. government securities or repurchase agreements backed by the U.S. government). ii. Funds could not invest more than 1% of fund assets in securities that have not received the highest rating (e.g., those rated below A-1 or P-1) of any one issuer. b. Quality i. A security would have to be rated high quality by all agencies assigning a rating to the security or issuer. A split rated security would be considered to have the lower rating. ii. Funds could not invest more than 5% of total fund assets in securities not having the highest rating. c. Maturity i. Funds would have to maintain a dollar-weighted average maturity that does not exceed 90 days. ii. Funds could not purchase an instrument with a remaining maturity of greater than 2 years. d. Holding Out Any fund that holds itself out as a "money market fund" would need to meet the conditions of Rule 2a-7 relating to portfolio diversification, quality and maturity. e. Tax-Exempt Funds Tax-exempt funds would be exempt from the 5% diversification requirement and the percentage limitations on investing in securities that do not have the highest rating. The release solicits comments on what conditions, if any, should be imposed on tax-exempt funds as a substitute for the diversification requirements and the five percent quality test, or whether it is possible to apply the same conditions applicable to taxable funds. Prospectus Disclosure The SEC proposes to require money market funds to prominently disclose 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 of \$1.00 per share. Advertising The definition of "money market funds" under Rule 482 of the Securities Act would be amended to include only those funds that meet the quality, diversification and maturity requirements of Rule 2a-7. May 8th Credit Analysis Letter Page 29 of the attached release includes a brief discussion of the staff's May 8th letter on credit analysis. The release, by noting that the staff's letter includes elements that a fund should consider in an

analysis of whether a security presents a minimal credit risk and that those factors do not constitute an exhaustive list, implies that a fund must consider those factors. Footnote 48 of the release reiterates the SEC's position that the board may delegate the day-to-day function of determining credit quality to the fund's investment adviser, provided that the board retains sufficient oversight. Comment Period The comment period for the proposed changes to rule 2a-7 expires 60 days after publication of the release in the Federal Register, which we anticipate will be in a couple of days. I would appreciate receiving, in writing, any suggestions you may have for possible inclusion in the Institute's comment letter no later than August 30, 1990. Amy B. Rosenblum Assistant General Counsel
Attachment

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