

MEMO# 1594

December 14, 1989

SEC STAFF RESPONSE TO INSTITUTE'S LETTER CONCERNING REGULATION OF MONEY MARKET FUNDS

December 14, 1989 TO: SEC RULES MEMBERS NO. 72-89 RE: SEC STAFF RESPONSE TO
INSTITUTE'S LETTER CONCERNING REGULATION OF MONEY MARKET FUNDS

Attached is a copy of the letter the Institute submitted to the SEC staff concerning the quality standards applicable to instruments held by money market funds and of the SEC staff's response. As you know, this past summer an issuer defaulted on its short-term commercial paper which was held by a number of money market funds. Shortly thereafter, the staff of the SEC requested that the industry review the current regulation of money market funds. Specifically, the staff sought input on whether steps should be taken to tighten up Rule 2a-7, the rule governing the use of amortized cost valuation by money market funds. The Institute formed an ad hoc committee to review this matter. As stated in the letter, the committee concluded that it was not desirable to amend the provisions of Rule 2a-7. Instead, the committee suggested that the Commission issue an interpretive release reiterating the obligation of the fund to analyze and monitor credit risk, as currently required by the rule. In connection with considering credit risk, the letter notes that it would be useful if the release included factors that might be considered in assessing credit risk. In addition, the letter recommends that the Guidelines to Form N-1A be amended to require (1) certain disclosures concerning the credit analysis undertaken by the fund and (2) that funds which purchase certain instruments be required to disclose this fact in their prospectuses along with any associated risks. In her response, Kathryn McGrath reiterated that Rule 2a-7 requires the board to undergo a two-part analysis of the money market instruments which may be purchased by the fund. While Mrs. McGrath agreed with the Institute's position that Rule 2a-7 did not need to be amended, she did not believe that it was necessary for the Commission to issue an interpretive release on the fund's obligation to determine and monitor credit risk, as suggested in the Institute's letter. The staff responded that such a release is not necessary since the rule is clear about the fund's obligations and, thus, there is nothing to interpret. Finally, the staff advised the Institute that the Office of Disclosure and Adviser Regulation will be evaluating the Institute's recommendation to amend the Guidelines to Form N-1A to require (1) certain disclosures concerning the credit analysis undertaken by or on behalf of the fund and (2) that funds which purchase certain instruments be required to include language in their prospectuses disclosing this fact and any associated risks. We will keep you informed of further developments. Amy B. Rosenblum Assistant General Counsel

Attachments

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