

**MEMO# 2784**

May 22, 1991

## **SEC CENSURES ADVISER TO MONEY MARKET FUND**

May 22, 1991 TO: MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 10-91 SEC RULES MEMBERS NO. 32-91 RE: SEC CENSURES ADVISER TO MONEY MARKET FUND

The SEC recently censured an investment adviser to a money market fund for violations of provisions of the Investment Company Act and the Investment Advisers Act. The adviser, without admitting or denying wrongdoing, agreed to settle the administrative proceeding. The adviser purchased for the fund an interest in an unrated master demand note issued by Drexel Burnham Lambert Inc. At the time of purchase, Drexel's commercial paper, which the adviser believed had the same characteristics as the note, was rated A-2 by Standard & Poor's. Several months later, the rating on Drexel's commercial paper was downgraded by the two agencies that had rated it. Rule 2a-7 of the Investment Company Act, upon which the fund relied to use amortized cost valuation, requires a fund to dispose of an instrument that falls below "high quality" (which, at the time of the alleged wrongdoing, was defined as the two top ratings of the nationally recognized statistical rating organizations), unless the fund's board of directors determines that it would not be in the best interest of the fund to do so. In this case, the fund did not dispose of the security, nor did the board make the requisite determination. Continuing to use amortized cost valuation, although the fund was not permitted to do so since it did not comply with the conditions of Rule 2a-7, resulted in a violation of Rule 22c-1 of the Act, which requires a fund to sell, redeem or repurchase shares at current market value (if market quotations are available). The SEC also found that the adviser misled shareholders about the fund's holdings in violation of Section 34(b) of the Investment Company Act and Section 206(2) of the Investment Advisers Act. To avoid having to list the Drexel note in the fund's annual report, the adviser sold the note to a company affiliated with the fund and bought it back on January 2, 1990. That transaction also violated Section 17 of the Investment Company Act, which prohibits certain companies affiliated with the fund from purchasing and selling securities to and from the fund while acting in a principal capacity. A copy of the SEC order is attached. Amy B.R. Lancellotta  
Assistant General Counsel Attachment