OPENING STATEMENT OF

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U.S. SECURITIES AND EXCHANGE COMMISSION

PROPOSED RULE 2A-7

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We have before us this morning amendments to Rule 2a-7 under the Investment Company Act, the rule governing investments by money market funds. Money market funds were first offered in the early 1970s and began to grow rapidly after 1978, when the Commission first approved the use of special valuation methods by money market funds. At the end of 1978, money market fund assets were $11 billion; at the end of 1982, over $200 billion was invested in money market funds. Today, over 20 million investor accounts hold total assets of over $530 billion.

Originally adopted in 1983, rule 2a-7 permits a money market fund to assume that the market value of a portfolio security is its amortized cost in computing net asset values each day. Rule 2a-7 is only available to a fund that meets strict conditions. Funds do not have to follow these guidelines, but if they do not, they must then mark to market all their portfolio securities.

In late 1989 and early 1990, several money market funds held second tier commercial paper of issuers that defaulted. The investors in these money market funds did not suffer any loss only because the advisers to the funds purchased the paper from the money market fund at amortized cost or principal amount.

In July 1990, the Commission proposed for comment amendments to tighten Rule 2a-7 in several important respects. We received over 200 comment letters. The staff has considered the comments carefully in formulating a final rule proposal. The proposal before us today would substantially strengthen the limits on money market funds. Among other things, the new rule would:

1. Limit the amount that a money market fund can invest in the securities of any one issuer to 5% of its portfolio. This compares with up to 25% of a portfolio which can currently be invested in a single issuer's securities.

2. Limit investments in second tier (A2-P2) paper to 5% of a fund's assets, compared with up to 100% today.

3. Limit investments in second tier paper of any one issuer to 1% of a fund's assets.

4. Rule 2a-7 now treats "split-rated" paper as having the highest rating given it by any rating agency. In July 1990, we proposed to reverse this rule, and give split-rated paper the lowest rating of any recognized rating agency. In response to comments, the staff proposes today a compromise: to give each issue of commercial paper the highest rating given to it by at least two recognized rating agencies.

5. To avoid any possibility of investor confusion on this issue, the cover page of any money market fund prospectus would be required to state that the fund is not insured by the U.S. government, and that there is no guarantee that the shares of the fund will maintain a constant value.

The proposed rules reflect the Commission's determination to protect more than 20 million account holders against unduly risky concentrations of portfolios and large-scale investments in higher-risk securities. Both under current law and the proposal, funds are not permitted to invest in securities whose ratings are below A2-P2.

It is very important to note that the proposed rules would not restrict all mutual funds from investing in second tier commercial paper. Indeed, there is nothing to prevent a fund from investing its entire portfolio in second and third tier paper, or even in junk bonds. Any such fund is free to offer a higher risk and higher yielding portfolio to investors. It need only disclose its holdings to investors and mark its portfolio to market. Indeed, one of the great strengths of the mutual fund industry is the diversity of investment strategies offered to investors, and nothing in the current proposal will restrict rich diversity of opportunity and investor choices. However, under this proposal funds that elect to pursue a higher risk strategy will be unable to hold themselves out as being almost like money.

The proposed rules would not remove all risk that money markets would be unable, because of commercial paper failures or other events, to maintain a stable asset value. Money market funds are not insured depository accounts, and investors should understand the differences when they decide whether to invest in a money market fund or deposit in a depository institution. They should also know, however, that the Commission will do everything it can to ensure the safety of money market funds. That includes not only rulemaking, but also an active inspection and enforcement program. Indeed, the Commission's policy is to inspect every money market fund at least once a year.