



DIVISION OF
INVESTMENT MANAGEMENT

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

December 9, 1992

Mr. Matthew P. Fink
President
Investment Company Institute
1600 M Street, N.W., Suite 600
Washington, D.C. 20036

Act	ICA-40
Section	
Rule	2a-7
Public Availability	12/9/92

Re: Investments in Illiquid Securities by Money Market Funds

Dear Mr. Fink:

In March of this year, the Commission revised the Guidelines to Form N-1A to increase the amount of illiquid securities an open-end investment company may hold from ten percent to fifteen percent of its net assets.¹ Recently, several money market funds relying on rule 2a-7 have sought to rely upon the Guidelines Release to adopt or amend their investment policies to permit investment of up to fifteen percent of their net assets in illiquid securities.

In its release, the Commission did not discuss specifically whether the higher limit would be appropriate for money market funds. The Division does not believe, however, that the Commission intended to change its longstanding position with respect to the acquisition of illiquid securities by money market funds.

The releases proposing, adopting and amending rule 2a-7 repeatedly emphasize the special duty of the board of directors of a money market fund to monitor purchases of illiquid securities.² In 1986, the Commission summarized this position:

[M]oney market funds often have a greater and perhaps less predictable volume of redemptions than other open-end investment companies. Further, the portfolio management of a money market fund might be impaired if a fund were forced to meet redemption requests by selling marketable securities that it would otherwise wish to retain in order to avoid attempting to dispose of illiquid portfolio instruments. Finally, the valuation of illiquid securities may potentially overstate or understate the fund's net asset value to the detriment of shareholders. In light of these potential problems, the board of directors of a money market fund relying on the rule must take steps to limit the acquisition of illiquid portfolio instruments to a level lower than the ten percent limit set for other types of open-end investment companies.³

¹ Investment Company Act Release No. 18612 (Mar. 12, 1992) ("Guidelines Release").

² See Investment Company Act Releases No. 12206 (Feb. 1, 1982) (proposing rule 2a-7); No. 13380 (July 11, 1983) (adopting rule 2a-7); No. 14983 (Mar. 12, 1986) (amending rule 2a-7); and No. 17589 (July 17, 1990) (proposing amendments to rule 2a-7).

³ Investment Company Act Release No. 14983 (citing Investment Company Act Release No. 13380, *supra* note 2).

Matthew P. Fink
December 9, 1992
Page 2

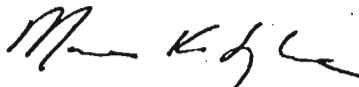
As recently as 1990, the Commission reaffirmed its views regarding the need for money market funds to maintain a liquid portfolio.⁴

The Commission revised the Guidelines to Form N-1A in March 1992 only after determining that, even during periods of abnormally high selling activity, mutual funds have had no difficulty meeting redemption requests from available cash reserves. The Commission thus concluded that the ten percent standard was overly conservative and that increasing it to fifteen percent was consistent with the protection of investors. In reaching this conclusion, however, the Commission did not consider the unique liquidity and valuation requirements of money market funds.

Furthermore, it does not appear that the Commission intended to include money market funds in the Guidelines Release. The Commission revised the Guidelines in connection with its efforts to make the capital markets more accessible to small businesses. While the revision does not require that any additional investments in illiquid securities be securities of small businesses, clearly small businesses were the intended beneficiaries. Money market funds generally cannot invest in the securities of small businesses by virtue of the rating requirements for eligible securities under Rule 2a-7.⁵

In summary, the staff does not believe the Commission intended to include money market funds among those funds that may invest up to fifteen percent of net assets in illiquid securities. In the absence of any other Commission statements on this topic, we assume the Commission continues to believe that money market funds should limit their acquisition of illiquid securities to less than ten percent. If you have any questions regarding the Division's position on this issue, please do not hesitate to contact me at (202) 272-2750, or Max Berueffy at (202) 272-2079.

Sincerely,



Marianne K. Smythe
Director

⁴ See Investment Company Act Release No. 17589 (July 17, 1990).

⁵ Thus, in estimating the significance of mutual funds as a potential source of capital for small business, the Commission "subtract[ed] from the total assets of mutual funds the assets of funds that ordinarily would not invest in the securities of small businesses [such as] money market funds." Guidelines Release, *supra* note 1, at n. 4.