



DIVISION OF  
INVESTMENT MANAGEMENT

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

May 26, 1995

Paul Schott Stevens, Esq.  
General Counsel  
Investment Company Institute  
1401 H Street, N.W.  
Washington, D.C. 20005

ACT ICA-40  
SECTION 22(e)  
RULE \_\_\_\_\_  
PUBLIC  
AVAILABILITY 5/26/95

Dear Mr. Stevens:

As you know, Rule 15c6-1 under the Securities Exchange Act of 1934, which will become effective early next month, establishes three business days ("T+3") as the standard settlement period for securities trades effected by a broker or dealer. 1/ The Investment Company Institute has requested the views of the Division of Investment Management regarding the implications of the T+3 standard in determining whether a security held by a mutual fund should be deemed to be liquid for purposes of the Commission's restrictions on mutual funds' holdings of illiquid securities. In particular, the Institute has asked whether the Division would deem a security with a demand feature that does not entitle the holder to receive the principal amount of the underlying security within three days to be an illiquid security. We understand that a significant amount of money market fund assets consists of securities with a seven day demand feature.

Section 22(e) of the Investment Company Act of 1940 provides, with certain exceptions, that no registered investment company may postpone the date of payment upon redemption of a redeemable security for more than seven days after the security is tendered for redemption. The Commission has stated that mutual funds should limit their holdings of illiquid securities to ensure that they can satisfy all redemption requests within the seven day period. 2/ The Commission considers a security to be illiquid if it cannot be disposed of within seven days in the ordinary course of business at approximately the price at which the fund has valued it. 3/ The usual limit on a fund's holdings of illiquid assets is 15% of its net assets. 4/ The 15% limit does not apply to money market funds; those funds are limited

- 
- 1/ Rule 15c6-1 generally provides that "a broker or dealer shall not effect or enter into a contract for the purchase or sale of a security (other than an exempted security, government security, municipal security, commercial paper, bankers' acceptances, or commercial bills) that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction." Securities Exchange Act Release No. 33023 (Oct. 6, 1993).
- 2/ Investment Company Act Release No. 14983 (Mar. 12, 1986) (adopting amendments to Rule 2a-7 under the Investment Company Act of 1940).
- 3/ *Id.* See also Securities Act Release No. 6862 (Apr. 23, 1990) (adopting Rule 144A under the Securities Act of 1933) (discussing the definition of "liquid" and citing Release No. 14983).
- 4/ Investment Company Act Release No. 18612 (Mar. 12, 1992) (revising Guides to Form N-1A).

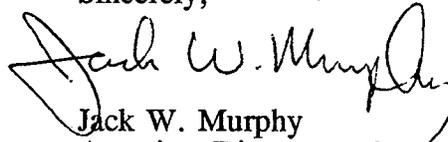
Paul Schott Stevens, Esq.  
May 26, 1995  
Page 2

to holding no more than 10% of their net assets in illiquid securities. 5/ The Commission has noted that, given the nature of money market funds, the difficulties that could arise in conjunction with holding illiquid securities may be even greater for those funds than for other types of open-end funds. 6/

Because Rule 15c6-1 applies to brokers and dealers, and does not apply directly to funds, it is the view of the Division that the implementation of T+3 does not change the standard for determining liquidity, which is based on the requirements of Section 22(e). We note, however, that as a practical matter, many funds will have to meet redemption requests within three days because a broker or dealer will be involved in the redemption process. Many of these funds hold portfolio securities that do not settle within three days. In light of the T+3 standard, such funds should assess the mix of their portfolio holdings to determine whether, under normal circumstances, they will be able to facilitate compliance with the T+3 standard by brokers and dealers. Factors that should be considered include the percentage of the portfolio that would settle in three days or less, the level of cash reserves, and the availability of lines of credit or interfund lending facilities.

The Division will monitor the industry's experience with T+3, and if necessary, will revisit this issue in the future. I hope this letter is responsive to your inquiries. Please call me at (202) 942-0660 if you have further questions.

Sincerely,



Jack W. Murphy  
Associate Director and  
Chief Counsel

---

5/ Investment Company Institute (pub. avail. Dec. 9, 1992).

6/ See Investment Company Act Release No. 14983, *supra* note 2.