The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 5621

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SUMMARY OF COMMITTEE MEETINGS ON SEC PROPOSAL

1February 28, 1994 TO: MONEY MARKET FUNDS AD HOC COMMITTEE NO. 5-94 RE: SUMMARY OF COMMITTEE MEETINGS ON SEC PROPOSAL

_____ As you know, the Institute held meetings on February 8 and February 15 to discuss the SEC's proposed amendments to Rule 2a-7 under the Investment Company Act of 1940. (See Memoranda to Money Market Funds Ad Hoc Committee No. 1-94 and 4-94, dated January 4, 1994 and February 10, 1994, respectively.) Set forth below is a brief summary of the meetings. The page numbers set forth below refer to the SEC's release on this proposal. February 8 Meeting I. General There was a general discussion that, where appropriate, the requirements under Rule 2a-7 should be consistent with respect to taxable funds and tax-exempt funds (which would include national and single state funds). This approach would avoid creating an overly complex rule, which in turn could produce significant compliance problems. In addition, concerns were expressed about the increased reliance on the rating agencies that would result under the proposed amendments. II. Amendments Relating to Tax-Exempt Funds A. Diversification (pp. 17-28) 1. National Funds (p. 19) - It was agreed at the meeting that, as proposed by the SEC, national tax-exempt money market funds should meet the five percent diversification test currently applicable to taxable money market funds (i.e., no more than five percent of the fund's assets may be invested in a single issuer). 2. Single State Funds (pp. 19-21) - The members supported the SEC's proposal to exempt single state funds from the five percent diversification test in connection with purchases of first tier securities. The members, however, recommended that single state funds be required to meet a five percent diversification test in connection with purchases of second tier GOs and other similar instruments. (See the discussion of the quality limitations proposed for single state funds in paragraph B.1. below.) 3. Concentration - In the section of the release dealing with diversification, the SEC solicited comment on whether tax-exempt funds should be limited with respect to their concentration in investments in certain securities (p. 21). The members felt very strongly that the Rule should not include such a limitation because it is not necessary and would create compliance burdens. In addition, it would further complicate the Rule. The one area in which tax- exempt funds may have a heavy concentration is in securities subject to puts, which may result in a concentration in the banking industry. The SEC's proposal, however, already addresses this in connection with the proposed disclosure 2requirement for a fund has more than forty percent of its portfolio subject to puts (p. 76). 4. Pre-Refunded Bonds (p. 22-23) - The members supported the proposal to allow funds to "look through" pre-refunded bonds where certain conditions have been satisfied. The members, however, did not support the proposal to limit a fund to investing up to twenty-five of its assets in the pre-refunded bonds of the same issuer. While members agreed that compliance with this proposal would not interfere with the

management of their portfolios, the need for such a requirement was questioned, since funds would never look to the issuer for payment where the bond was fully funded and secured by escrowed Government securities. The only risk with pre-refunded bonds are potential problems with the escrow agent or in the terms of escrow agreement. For this reason, the SEC has proposed adequate safeguards that must be met before the fund can "look through" to the escrowed securities. 5. Diversification Safe Harbor (p. 23-24) - The mmbers generally supported the proposed amendment to prohibit a taxable or national fund from investing more than twenty-five percent of its assets in a single issuer under the three-day safe harbor from the diversification requirement. B. Quality Limitations (pp. 24-28) 1. Single State Funds (pp. 24-25) - We discussed that the SEC's proposal to tighten the quality limitations applicable to single state funds in such a restrictive manner in order to balance the fact that they would not be subject to a diversification requirement is misguided. There is not a direct relationship between diversification and quality. Moreover, there is no significant justification for imposing such different requirements on single state funds than on national and taxable funds, which would unduly increase the complexity of the Rule. Based on the foregoing, members recommended that the SEC's proposal be modified to allow single state funds to invest up to five percent of their assets in second tier securities (and no more than the greater of one percent of its assets or $1 million of securities issued by that single issuer). In addition, single state funds, like national funds, should be able to invest, without limitation, in second tier government obligations (GOs) and cash-flow borrowing notes. [Members at the meeting stated that they would provide me with suggested definitions for this category of securities. It would also be useful if members could provide me with any materials describing the difference in risk between a second tier GO and other second tier instruments in support of the argument that second tier GOs should be treated differently under Rule 2a-7.] In support of this recommendation, it was noted at the meeting that the reasons set forth in the SEC's release for allowing national funds to invest in second tier GOs and similar instruments apply equally with respect to single state funds. The only difference is that national funds are subject to a five percent diversification requirement. Therefore, to provide parity and reduce risk, single state fund investments in second tier GOs and similar instruments also should be subject to a five percent diversification requirement. 2. National Funds (pp. 25-28) - The members supported the proposal to prohibit a national fund from investing more than five percent of its assets in "conduit securities", except that the members disagreed with the definition of "conduit securities". Instead of the approach adopted by the SEC limiting investment in "conduit securities", it was recommended that national funds, like single state funds, be limited to investing up to five percent of its assets in all second tier securities, except for GOs and cash-flow borrowing notes issued by states and municipalities. While this approach seems to yield the same 3result, it avoids having to wrestle with the definition of "conduit securities". In addition, it may serve to preclude creative issuers and dealers from creating second tier securities that are outside the scope of the definition of "conduit securities", but are not as safe as GOs and other similar instruments. [To protect against this potential abuse from occurring under the approach recommended at the meeting and to avoid interpretive issues from arising, it is important that we develop a very precise definition of the instruments that fall within the category of "GOs and cash-flow borrowing notes." As noted above, members have indicated that they will be providing me with suggested definitions for this category of securities.] 3. Split-Rated Securities - It was agreed at the meeting that we should continue to urge the SEC to modify the treatment of split-rated securities along the lines suggested in the Institute's 1991 submission to the staff on tax-exempt money market funds. The Institute recommended that funds be permitted to treat split-rated securities as being of the higher rating, so long as at least 50% of the agencies rating that security have assigned it the highest rating. 4. NRSROs Ratings Comparability

(pp. 28-30) - In response to the SEC's request for comment on comparability of the NRSROs' tax-exempt rating categories, the members commented that while there was some lack of comparability, it really was not a problem. It was noted that in some cases Moody's was "stricter" than S&P, while in other cases it was reversed. Therefore, it appears that the lack of comparability was evenly balanced and not problematic. C. Puts and Demand Features (pp. 30-52) 1. Put Diversification Requirements (p. 33-34) - The members supported the SEC's proposal to permit a fund to invest up to ten percent of its assets in securities subject to conditional puts provided by a single issuer, as is currently permitted for securities subject to unconditional puts. The members did not express concern with the proposed change to require that a fund's securities subject to conditional and unconditional puts be aggregated for purposes of the overall ten percent limit on investments in securities subject to puts. Several members expressed the need to clarify that the put diversification requirements should apply only to puts that run to third parties (e.g., a bank LOC provider) and not to issuer provided puts. Issuer provided puts should not be subject to the put diversification requirements because the issuer itself is already subject to the general diversification requirements under the Rule. Thus, there is no need to double count that issuer for diversification purposes. In addition, it was agreed that the statement in footnote 81 of the release that bond insurance would be considered to be a put for purposes of Rule 2a-7 should be modified. Puts and guarantees should not be treated the same under the Rule. Puts are provided for liquidity purposes, whereas guarantees are used to reduce credit risk. The treatment of guarantors for diversification purposes is already adequately addressed under Rule 5b-2 under of the Investment Company Act. Thus, there is no need to address it under Rule 2a-7. 2. Twenty-Five Percent Basket (pp.34-35) - Members were concerned that if the twenty-five percent put basket were eliminated, tax-exempt funds, especially single state funds, would be forced to purchase lower quality puts. In an effort to tighten this provision, while providing single state funds with the ability to invest up to twenty-five percent of its assets in securities subject to puts from a single provider, it was recommended that there be a twenty-five percent put basket for single state funds only for first tier puts. [Why don't national funds need this basket?] 43. Multiple Put and Guarantee Providers (p. 36) - The members objected to the proposal that where there is more than one put provider, each entity be deemed to have guaranteed the entire principal amount. The underlying rationale for the proposal seems to be that there is a "weak link" in the chain, when that is generally not the case. For example, where a second put has been obtained and is "wrapped" around the first put, the fund will look only to the second put provider for payment. To require that the first put provider be counted for diversification purposes is irrational because it would force the fund to consider a weak credit provider for purposes of compliance with the Rule, even though the fund will not look to that provider for payment. A more rational approach would be to consider both entities as having guaranteed the entire principal amount where their liability is joint and several and, where their liability is several, but not joint, to count each entity's exposure as it is explicitly allocated in the underlying documentation. 4. Put Providers and Ratings (pp. 37-40) a. Puts in Excess of Five Percent of Assets (pp. 37-38) - Members indicated that it would not be a problem to comply with the proposed requirement that, when a fund invests more than five percent of its assets in securities supported by a put from a single put provider, the put provider's short-term debt obligations be rated in the highest category, so long as the proposal is modified to allow a fund to make a comparability determination where the put provider does not have rated short-term debt obligations outstanding. This change would be consistent with the approach followed under the other quality requirements under the Rule and would address the industry's general concern about placing too much reliance on the rating agencies. It was also recommended that the second part of this requirement, i.e., that the fund dispose of securities backed by an institution that is no longer first tier, be modified (1)

so that instead of a "fire sale" approach, the requirement is consistent with the fund's obligation where a security has been downgraded, i.e., the board of directors shall reassess promptly whether such security presents minimal credit risks and shall cause the fund to take such action as the board determines is in the best interests of the fund and its shareholders, and (2) to include a requirement that the adviser "be aware of or should have been aware of" the downgrading so that the fund will not be in violation if there is a downgrading that the adviser could not reasonably have learned about. b. VRDNs (p. 39-40) - Members opposed requiring that VRDNs be rated or, alternatively, that in those cases in which a VRDN is rated, funds be required to rely on the rating of the VRDN (i.e., the entire structure) rather than the rating of the demand feature. Again, requiring that VRDNs be rated unjustifiably places too much reliance on the rating agencies. With respect to relying on the specific rating of the VRDN, members opposed this proposal noting that, when the rating agencies rate VRDNs, the rating is not done on the basis of Rule 2a-7 and thus the rating may not be appropriate. [It would be helpful if a member could clarify this concern and provide us with an example illustrating the concern.] 5. Issuer Demand Features (p. 40) - In response to the SEC's inquiry regarding the appropriateness of issuer demand features, members noted that generally only the best rated issuers provide demand features. Prohibiting issuers from issuing demand features would essentially result in penalizing the best rated credits available in the marketplace. This change also could push funds into purchasing more bank provided puts thereby causing an even greater concentration in bank instruments. 6. Non-Bank Put Providers (p. 40) - In response to the SEC's request for comment on whether fund reliance on non-bank put providers should be limited, members agreed that there should not be a distinction between bank and non-bank 5put providers. Rule 2a-7 requires that funds make a minimal credit risk determination with respect to the put provider. Based on that determination, the fund decides whether or not to purchase that particular security. Thus, there is no justification for such a distinction. Moreover, there is a limited supply of highly rated put providers. The SEC should not take any action that could exacerbate the problem. 7. Conditional Puts (pp. 41-42) - With respect to the proposal to limit the permissible conditions for a conditional puts, the members recommended that the adopting release clarify that these conditions are of the type that would cause the put to terminate immediately, without notice to the bondholder, and that other conditions that provide for remedies (such as a mandatory tender or an acceleration) would be appropriate, so long as the fund would receive payment. In other words, a condition would be permissible if the fund will get paid and it would be impermissible if the triggering of the condition results in the fund holding a long-term instrument. It was also recommended that there be an appropriate transition period for this requirement since funds may be holding a number of conditional puts that would not meet the proposal. Specifically, a transition period of the longer of six months or the next opportunity to exercise the put was suggested. Finally, several members noted that they had technical comments on the specific conditions set forth in the proposal. These comments were not discussed at the meeting. [Instead, these members were asked to provide me with their comments after the meeting.] 8. Puts and Fund Liquidity (pp. 51-52) - There was a brief discussion on the difference between conditional puts and standby commitments. We discussed that standby commitments are used solely for liquidity purposes and not for shortening maturity, which is what conditional puts are used for. Thus, standby commitments should not be counted for put diversification purposes. It was noted that standby commitments used to be more popular and are hardly used today. Funds do not, however, want to lose the flexibility of being able to use them in the future. Therefore, the Rule should not be amended to preclude the use of standby commitments. On a related matter, several members expressed general concerns about the definitions of "conditional put", "demand feature" and "standby commitment". We did not discuss the specific concerns raised by these

definitions, although we did discuss that there is no need to have a definition of "conditional demand feature" because all conditional puts have demand features. Please provide me with any specific concerns that you have with these definitions. Finally, in response to the SEC's inquiry as to whether conditional demand features and standby commitments are actually used to provide liquidity or merely create the appearance of liquidity, the members agreed that they are in fact used for liquidity purposes. D. Review and Information Requirements (pp. 52-57) 1. Continuing Disclosure and Review Requirement (p. 53) - The SEC proposed to require funds to adopt written procedures concerning ongoing reviews of the credit risks of securities for which maturity is determined by reference to a demand feature. The members supported the concept of such written procedures, but suggested that they be adopted for all securities and not just for those whose maturities are determined by reference to a demand feature. It was recommended that it be stressed to the SEC that a written memorandum on the review of every security should not be required. Written procedures should be adequate for facilitating compliance with the Rule. (Of course, a written memorandum for each security would be required relating to the initial minimum credit risk determination.) 62. Analysis of Underlying Securities Subject to Unconditional Demand Features (pp. 54-55) - The proposal would require funds to review or have available information about the issuer of an underlying security that is backed by an unconditional demand feature where there is a significant adverse change in the credit quality of the put provider or the impending expiration of the put. Members suggested that a security that provides for a mandatory tender upon the expiration or termination of the LOC should not be subject to this requirement, since the fund is entitled to full payment at that time. In addition, where there has been a full credit substitution, funds should not be required to review or obtain information about the underlying issuer. Under these circumstances, funds only need to analyze and monitor the credit quality of the LOC provider. Members noted that this requirement seemed to be addressing the broader issue of market disclosure and that Rule 2a-7 was not the appropriate vehicle for doing so. Members recommended grandfathering in securities currently outstanding that would not be able to meet this information requirement. On a related issue, there was a general discussion about the problems funds have in receiving notification from DTC and trustees when there is a substitution of an LOC provider or other significant event about which funds should be made aware. It was suggested that an industry group meet with DTC and talk to them about their potential liabilities for failure to provide such notification. [Please let me know if you would like the Institute to pursue this and if you would like to participate on this project.] E. Adjustable Rate Securities (pp. 57-65) (We finished discussing the proposals in this section of the Release at the February 17th meeting, which is summarized below) 1. Maturity of Variable Rate Securities (p. 59) - Members agreed that the standard for determining the maturity of a variable rate security should be the date on which the fund has the right to receive payment, i.e., the shorter of the period remaining until principal can be recovered on demand or the final maturity. In response to the SEC's request for comment on whether funds should be permitted to use the interest rate reset date to determine the fund's weighted average portfolio maturity, members expressed the view that funds should be permitted to do this, so long as, upon readjustment, the security can reasonably be expected to have a market value that approximates par value. Using the interest rate reset date, rather than the date on which the fund would receive payment, would more accurately reflect the interest rate risk of the fund. In summary, the standard for determining the maturity of a variable rate security, which is used to determine eligibility under the Rule, would be the earlier of the final maturity or the demand date. Average weighted portfolio maturity should be determined using the next interest rate readjustment date, so long as, upon readjustment, the security can reasonably be expected to have a market value that approximates par value. F. Disclosure Requirements (pp.

74-77) 1. Single State Funds (p. 75) - Members generally supported the proposed disclosure requirements for single state funds. It was recommended that it be clarified that this disclosure does not have to included on the cover page of the fund's prospectus. Members also recommended modifications to the proposed disclosure so that instead of stating that an investment in a single state fund 7"may be riskier" than an investment in other types of money market funds, the disclosure would state that "there may be a greater risk that the fund will not be able to maintain a stable net asset value." 2. Exposure to Put Providers (pp. 76-77) - With respect to the proposed disclosure that would be required for a fund that has more than forty percent of its assets subject to puts, members strongly opposed disclosure stating that "letters of credit are not necessarily subject to federal deposit insurance." Members felt that this disclosure would clutter up meaningful disclosure and that it could be misleading since there are other put providers besides domestic banks. More importantly, it could increase the existing confusion that exists with respect to the non-insured status of money market funds. 3. Identification of Put Providers (p. 76) - Members supported the proposal to include the name of put providers in the fund's portfolio schedule. III. Proposed Exemptive Rule Members opposed the proposed exemptive rule governing purchases of certain portfolio instruments by affiliated persons. Such a rule could create a false inference regarding the safety of money market funds and mislead advisers into believing that they are obligated to purchase a defaulted security. IV. Transition Period The proposed 90 day transition period seems to be adequate for most of the proposed changes, except in those instances where a fund would need to modify existing securities (such as the changes regarding the types of conditions that would be permitted for conditional puts). In those instances, the transition period should be the longer of six months or the next opportunity to sell or modify the security. February 17 Meeting I. Asset Backed (ABS) and Synthetic Securities (pp. 42-52) A. General - Members opposed the SEC's approach of including ABSs and synthetics together in tailoring regulation for these products. These products are very different and generally are purchased by different buyers (i.e., ABSs are purchased primarily by taxable funds, whereas synthetics are purchased primarily by tax-exempt funds). Members generally felt that there is no need to develop special provisions for synthetics or ABSs under Rule 2a-7. These instruments should be treated like all other instruments under the Rule, except with respect to the application of the diversification requirements to ABSs, as discussed below. B. Specific - The SEC's release solicited comment on a number of proposals relating to ABS, which are discussed below. 1. NRSRO Ratings - Members strongly opposed the proposed requirement that funds be permitted to purchase only rated ABSs. Consistent with the concerns expressed above where ratings were proposed to be required under other provisions of the Rule, this requirement would place too much reliance on the rating agencies. In this context, such reliance would be especially misplaced because the rating agencies perform only a limited review of ABSs. The agencies only measure the likelihood of repayment and do not look at other pertinent features, such as the tax issues and eligibility under Rule 2a-7. In addition, limiting funds to only rated ABSs would preclude them from buying some of the more innovative programs being offered today and in which the funds often 8help structure. As an alternative to this proposal, the SEC solicited comment on whether fund investments in ABSs should be limited to a specified percentage. Members strongly opposed such a limitation. Among other things, such a limitation could force to funds to purchase riskier securities, since ABSs present less credit risk than many other instruments. 2. Maturity - Members agreed that the 397 day maturity requirement applicable to all other instruments under the Rule should apply to ABSs as well. Thus, funds should not be permitted to purchase ABSs that do not provide for payment within 13 months. (The SEC's proposal was more liberal in that it would have allowed funds to measure maturity by reference to the date on which the principal is scheduled to be repaid, rather than on the date on which the

principal must be repaid.) With respect to weighted average portfolio maturity, it was agreed that ABSs should be subject to the same standard that was recommended above for all other instruments under Rule 2a-7 (i.e., the interest rate reset date may be used for weighted average maturity, so long as the security can reasonably be expected to have market value that approximates its par value). The SEC should clarify in the adopting release, however, that ABSs would only be able to use this standard if the interest reset provision will be in place for the entire life of the deal. 3. Diversification - Members expressed serious concerns with the terminology used by the SEC in connection with the proposed diversification requirements for ABSs. For example, their use of the term "issuer" in this context would mean that all credit card holders whose receivables are pooled together would be deemed to be "issuers" for these purposes. Does this mean that the credit card holders have issued securities under the federal securities laws? Instead, it was recommended that the term "obligor" be used for describing the underlying debtors. In response to the SEC's inquiry as to whether a sponsor should be treated as an issuer for diversification purposes, members stated that the only instance in which this would be appropriate is when the sponsor is providing the credit. Thus, the same analysis that is undertaken under Rule 2a-7 for instruments where there has been a credit substitution or enhancement would apply to ABSs. The relevant inquiry underlying the diversification analysis in these instances is, "who is the fund looking to for payment?" This is the same question that is asked whether it is an ABS or an LOC enhanced security. Where the sponsor has not provided the credit, there is no justification for treating it as the issuer under the diversification requirements. Members suggested a stricter standard for diversification than what the SEC had proposed. Members suggested that where the pool of obligors meets the diversification requirement currently applicable to taxable money market funds (i.e., no more than five percent of the pool is comprised of the debt of any single obligor), the pool should be considered to be the issuer. This is generally consistent with the approach proposed by the SEC with respect to a money market fund investing in another money market fund. Where the pool does not meet the diversification requirements, funds should be required to look through to the obligors for purposes of the diversification requirements. This approach would ensure that a fund has not invested a significant amount of its assets in a single obligor. [How would funds determine whether the pool is diversified?] 4. First Loss Guarantor - It was agreed that the SEC's proposal to treat a first loss guarantor (i.e., a guarantor who guarantees losses up to a specified percent of the assets of the pool) as the guarantor of the entire security for diversification purposes is misguided. Instead, where there is joint and several liability, each guarantor should be treated as guaranteeing 9the entire ABS; where the parties' liability is several and not joint, each party should be deemed to have guaranteed the percentage explicitly set forth in the underlying documentation. This is the same approach recommended above under Item C.3. II. Adjustable Rate Instruments A. Recordkeeping - The SEC has proposed to require funds to maintain records of the determination, with respect to a security which is determined by reference to the next interest rate reset date, that the instrument will either maintain a value of par (for a floating rate instrument) or return to par (for a variable rate instrument). In response to the SEC's inquiry as to whether this recordkeeping requirement is reasonable, members stated that it was overly burdensome. Members agreed that funds should have written procedures for making this determination, but that it was too onerous to prepare a written memorandum for each instrument. B. Duration - In connection with its discussion in the release on adjustable rate instruments, the SEC solicited comment on, among other things, whether the Rule should establish interest rate risk criteria based on "duration" as opposed to maturity. Members generally supported using duration instead of weighted average portfolio maturity under Rule 2a-7. One member noted that the use of duration would have prohibited funds from buying many of the new instruments that were

being peddled to money market funds as meeting the literal requirements under Rule 2a-7 (such as inverse and capped floaters). Members expressed the view that maturity does not really mean anything in today's marketplace and that most funds use duration internally in analyzing the interest rate risk of a particular instruments. Several members noted that duration in the money market fund context is fairly simple. Members also noted that steps should be taken to begin educating investors about duration, since it is a much more meaningful measurement than maturity, and that Morningstar is going to start publishing duration. As discussed at the meeting, this is an issue that would require further study and consideration. It may be appropriate to float the idea of using duration in the Institute's comment letter, but hold off in making any specific recommendations until we have had an opportunity to explore it more fully. [Members at the meeting were asked to send me information on the different standards used for duration and recommendations on how to define duration.] III. Repurchase Agreements A. General - It was recommended that the language on page 66 of the release, which states that a lender under a repo agreement would be able to liquidate the underlying collateral and get its money immediately, be clarified to state that a lender would be able to get its money promptly. This would be a more accurate statement of existing practice. The Bankruptcy Code definition, which is cited in the release and which includes immediately, should not be used for Rule 2a-7 purposes because certain institutions are not subject to the Code (such as the FDIC, domestic branches of foreign banks). B. Specific Comments - First, in response to the SEC's request for comment on whether funds should be permitted only to enter into repos when they may "look through" the counterparty, members agreed that funds should not be limited in this manner. Second, the SEC asked for comment on the need to retain the current requirement that funds make a minimal credit risk determination with respect to counterparties of repos that are collateralized fully. Members stated that funds should be required to make an analysis of the counterparty, but not necessarily 10 a credit risk determination. Instead, funds should analyze the risk of default prior to maturity. [I am not sure I understand the difference between a credit risk determination and an analysis of the risk of default prior to maturity. What do funds do now in this regard? Shouldn't the creditworthiness determination that funds make for Rule 2a-7 purposes be the same standard described in Release 13005 regarding funds entering into fully collateralized repos with broker-dealers?] Third, members suggested that paragraph (d)(6) of the Rule, relating to the maturity of a repurchase agreement, be amended to delete the words "no date is specified" in order to allow funds to buy repos with a final stated maturity and a demand feature. The Rule, as currently drafted, seems to allow funds to purchase only repos with demand features that do not have a stated final maturity. [Do funds currently purchase repos with a final stated maturity and a demand feature?] 11 IV. Miscellaneous A. Long-term Ratings - Members recommended reiterating the recommendation in the Institute's letter on the 1990 money market fund proposal that funds be permitted to purchase a security that at the time of issuance was a long-term security, so long as the security was not rated below the three highest rating categories. Rule 2a-7 currently uses the two highest rating categories as the cut off. B. Portfolio Quality; Puts - Members recommended modifying paragraph (c)(3) of the Rule dealing with the quality determination of instruments subject to either an unconditional or conditional demand feature so that the requirement is consistent in both instances. Specifically, Rule 2a-7 permits a fund, in connection with a security subject to an unconditional demand feature, to look either to the underlying security or the put in making a quality determination. In contrast, with respect to a security subject to a conditional demand feature, a fund may only look to the quality of the conditional demand feature in determining the eligibility of the instrument under Rule 2a-7. * * * I intend to circulate a draft comment letter on the SEC's proposal shortly reflecting the positions agreed upon at the February 8 and 17 meetings, which are

summarized above. Please provide me with any comments you have on these positions by March 11, 1994. My direct number is 202/326-5824 and the fax number is 202/326-5828. Amy B.R. Lancellotta Associate Counsel

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