MEMO# 2351

November 29, 1990

DECEMBER 18 MEETING TO DISCUSS TAX-EXEMPT MONEY MARKET FUNDS

- 1 - November 29, 1990 TO: MONEY MARKET FUNDS AD HOC COMMITTEE NO. 5-90 RE: DECEMBER 18 MEETING TO DISCUSS TAX-EXEMPT MONEY MARKET FUNDS ____ The Institute has scheduled a meeting for Tuesday, December 18, 1990 to discuss recommendations to the SEC concerning the regulation of tax-exempt money market funds. Set forth below is a draft proposal that was developed by the Institute and several members of the Committee. This proposal differs slightly from the proposal that was previously circulated to you. (See Memorandum to Money Market Funds Ad Hoc Committee, dated October 30, 1990.) We will discuss this proposal at the December 18th meeting. In preparation for the meeting, we recommend that you discuss the proposal with your firm's portfolio managers. Draft Proposal I. National Tax-Exempt Funds A. Diversity - Require that funds invest no more than 5% of their assets in securities of any one issuer and no more than 10% of their assets in securities subject to a guarantee issued by any one institution. (Same standard as proposed for taxable funds.) B. Quality 1. Unrated Securities - Allow funds to start with a 5% basket of unrated securities (defined as securities which have not been rated and are issued by an issuer that does not have other rated short-term debt or rated long-term debt outstanding). An unrated security with an unconditional and irrevocable credit enhancement will be considered to be a rated security for these purposes. (We will discuss at the meeting the extent to which a credit enhancement must be unconditional for purposes of making an unrated security rated.) The 5% basket would be phased out over a one year period. Thereafter, the standard would be the - 2 - same as proposed for taxable funds. However, since municipal long-term bonds often have very old ratings, tax-exempt funds would be permitted to buy an unrated security of an issuer that does not have other short-term debt outstanding only if the issuer's long-term debt has a "current" rating. The definition of "current" rating was not resolved. (Please discuss this with your portfolio managers.) 2. Securities Not Receiving the Highest Rating - Restrict fund investments in securities not receiving the highest rating to 10% of their assets and up to 3% per issuer. (These are the same limits as those proposed for taxable funds with respect to split-rated securities.) 3. Split-Rated Securities - No limit should be imposed on the amount of split-rated securities that a fund may purchase provided that at least one of the ratings is the highest. II. Single State Funds A. Use of Words "Single State" - Require disclosure on the cover page of the prospectus that the fund is a "single state" fund and that there may be additional risks as a result of concentrating in securities issued by issuers domiciled in only one state. B. Diversification - Single state funds would not be required to be diversified. Disclosure concerning diversification would be required depending on whether the fund is 5% diversified with respect to 100% of its assets, 5% diversified with respect to 75% of its assets or non-diversified (as defined under Section 5 of the 1940 Act). C. Quality - Funds would be limited to a permanent 25% basket made up of both unrated securities and securities not having received the highest rating. (Consideration was given to limiting unrated securities to 10% within the 25% basket.) III. Opinions of Counsel We will also discuss at the meeting requiring funds to obtain a clean opinion of counsel as to the tax-exempt status of portfolio securities. * * * The meeting is scheduled for 10:00 a.m. at the Institute. Please contact Michele Dugue by December 13 at 202/955-3515 to let her know whether you will be able to attend the meeting . Amy B.R. Lancellotta - 3 - Assistant General Counsel