

MEMO# 6068

July 21, 1994

SEC STAFF LETTER ON THE ELIGIBILITY OF CERTAIN CALIFORNIA WARRANTS UNDER RULE 2A-7

July 21, 1994 TO: MONEY MARKET FUNDS AD HOC COMMITTEE NO. 15-94 MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 7-94 SEC RULES MEMBERS NO. 50-94 RE: SEC STAFF LETTER ON THE ELIGIBILITY OF CERTAIN CALIFORNIA WARRANTS UNDER RULE 2a-7

_____ The Division of Investment Management issued a letter providing guidance concerning the ratings assigned to Series C Revenue Anticipation Warrants issued by the State of California ("RAWs") for purposes of determining their eligibility under Rule 2a-7 under the Investment Company Act of 1940. A copy of the letter is attached. The RAWs will mature within 22 months from date of issuance. Principal and interest on the RAWs is guaranteed by the unconditional obligation of a consortium of fourteen banks to purchase the RAWs on a specified date. The RAWs are intended to be repackaged into Variable Rate Instruments (as defined in Rule 2a-7) for sale to money market funds. In addition, the variable rate RAWs will be subject to a conditional demand feature which permits the holder to put the instrument back on each interest rate reset date. The RAWs will receive "short-term" ratings from three rating agencies within the highest rating category for short-term municipal obligations. The short-term obligations of each of the consortium member banks and the issuers of the demand features will also be rated in the highest short-term categories. In order for an instrument subject to a conditional demand feature to be an eligible security for purchase by money market funds, Rule 2a-7(c)(3)(ii) requires, in pertinent part, that (1) the demand feature be rated by the Requisite NRSROs (as defined in the Rule) in one of the two highest rating categories for short-term debt obligations and (2) the underlying security be rated in one of the two highest rating categories for long-term debt obligations. Interpretive guidance was requested because the underlying security in this case, i.e., the RAWs, would not be assigned a "long-term" rating. The staff stated that it would not object if "money market funds purchasing the [variable rate] RAWs treat the short-term ratings assigned to the RAWs as ratings assigned to long-term debt obligations for purposes of paragraph (c)(3)(ii) of rule 2a-7." The staff's letter does not address the issue of whether these instruments present minimal credit risks, which a fund's board (or its delegate) must determine based on factors other than the ratings assigned by the NRSROs. Amy B.R. Lancellotta Associate Counsel Attachment

should not be considered a substitute for, legal advice.