MEMO# 5651

March 7, 1994

MODIFICATION TO PROPOSED POSITION REGARDING FUNDS' ABILITY TO PURCHASE SECOND TIER MUNICIPAL SECURITIES

March 7, 1994 TO: MONEY MARKET FUNDS AD HOC COMMITTEE NO. 6-94 RE: MODIFICATION TO PROPOSED POSITION REGARDING FUNDS' ABILITY TO PURCHASE SECOND TIER MUNICIPAL SECURITIES ____ As you know, at the February 8 meeting of the ad hoc committee it was discussed that the Institute would recommend that the SEC modify the proposed quality limitations applicable to single state tax-exempt money market fund in a manner consistent with the proposal for national funds so that all tax-exempt money market funds would have a 5% basket (with a 1% per issuer limitation) for second tier "conduit securities". This change would allow all tax-exempt funds to be able to invest up to 100% of their assets in second tier GOs and other similar instruments, subject to a 5% per issuer diversification requirement. (See Memorandum to Money Market Funds Ad Hoc Committee No. 5-94, dated February 28, 1994.) This approach is a significant change from the recommendation submitted by the Institute to SEC staff in 1991. The Institute had recommended that the 5% limit on second tier securities applicable to taxable funds be adopted for both national and single state funds, provided that funds be permitted to treat split- rated securities as being of the same quality as the higher rating, so long as at least 50% of the agencies rating that security have assigned it the highest rating. After further consideration of this issue, and discussions with various members and the rating agencies, we believe the Institute's 1991 recommendation would be a preferable approach. It does not appear that this approach would have a significant impact on national or single state funds because, among other things, funds currently have only about 8% of their assets invested in second tier securities and, if the treatment of split-rated securities is modified, the overwhelming majority of municipal obligations will be first tier. In addition, as was discussed at the February 8 meeting, there have not been any significant changes in the marketplace since 1991 when this committee developed the Institute's recommendation. Accordingly, we would urge that the Institute's comment letter reiterate the position expressed in our 1991 letter with respect to second tier securities and the treatment of split-rated securities. We also would recommend that our comment letter suggest, as an alternative, that second tier securities be treated in the manner discussed at the February 8 meeting (i.e., a 5% basket for only "conduit securities"). Please call Amy Lancellotta at 202/326-5824 by March 14 if you have any comments on this matter. Paul Schott Stevens General Counsel