

May 28, 2009

Investment Company Act of 1940
Rule 2a-7
Section 34(b)
Section 35(d)
Rule 22c-1

Douglas J. Scheidt, Esq.
Associate Director and Chief Counsel
Division of Investment Management
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

**Re: No-Action Request Concerning the Eligibility for Acquisition by Money Market
Funds of Window Variable Rate Demand Bonds**

Dear Mr. Scheidt:

Citigroup Global Markets Inc. (“Citigroup”) wishes to offer registered open-end management companies operating as money market funds in reliance on Rule 2a-7 of the Investment Company Act (the “1940 Act”) the opportunity to invest in Window Variable Rate Demand Bonds (“WVRDBs”), as described more fully below. A WVRDB is designed to provide money market funds with an investment that provides minimal credit risk as well as liquidity. The liquidity offered to investors will be “unconditional” and will be provided by the issuer¹ rather than a third-party financial institution.

¹ In some cases, the WVRDB is a “Conduit Security,” as such term is defined in Rule 2a-7(a)(7) (“a security issued by a Municipal Issuer . . . involving an arrangement or agreement entered into, directly or indirectly, with a person other than a Municipal Issuer, which arrangement or agreement provides for or secures repayment of the security”). In such cases, references in this letter to the “issuer” are to the underlying obligor who provides for the repayment of the WVRDB.

On behalf of Citigroup, we hereby request that the staff of the Division of Investment Management (the “Staff”) affirm that it would not recommend that the Securities and Exchange Commission (the “Commission”) take any enforcement action under Section 34(b) or 35(d) of the 1940 Act or Rule 22c-1 thereunder against a money market fund if the fund acquires and treats a WVRDB as a “Long Term Variable Rate Security” for the purposes of paragraph (d)(3) of Rule 2a-7 under the 1940 Act, provided that the fund complies in all other respects with Rule 2a-7, as now in effect, or may be amended in the future.

FACTS

I. Current Market Conditions for Variable Rate Bonds and Benefits of WVRDBs

Due to the ongoing financial crisis, the market for traditional variable rate bonds has been significantly disrupted. Traditional variable rate bonds generally require bond insurance or credit support from a bank and external bank support to support payment of purchase price. However, Citigroup has found that with the “freezing” of the credit markets that bank support has been exceedingly difficult to obtain and that with the significant drops to their credit ratings, most bond insurers are not viable for money market fund eligibility (with regard to both existing and new programs). As a result, it has become substantially more difficult for municipal issuers in particular to issue and maintain existing variable rate bond programs.

Citigroup believes that the current disruption in the variable rate bond market imposes significant hardship on both public sector issuers and money market funds. Citigroup has found that this hardship affects not only new issuances but also existing issuances, where the existing credit providers present greater credit risks than are appropriate for money market funds. Variable rate bonds have historically provided municipal borrowers the lowest cost of funds. The difficulty in obtaining financing through the variable rate bond market has increased financing costs to these issuers at a particularly difficult time since declining tax revenues have put a great strain on operating budgets. This has come at a time when many of these issuers will require financing in order to fulfill their role in the economic recovery through the development of infrastructure projects.

WVRDBs provide critical assistance to public sector issuers by creating greater access to the variable rate markets. First, for qualifying highly rated issuers, they do not require bond insurer support, credit support or external bank support. In addition, WVRDBs eliminate the daily/weekly put risk for issuers. Finally, given the role that public sector issuers are expected to play in the recovery (through, for example, their investment in infrastructure projects), providing an additional means of accessing the variable rate financial markets without further governmental assistance could be critical.

Furthermore, the developments in the financial sector have also dramatically curtailed the number of appropriate investments available for money market funds (while the amount of money held in money market funds has considerably increased as investors have allocated more of their portfolios away from the equity markets). Citigroup also believes that many traditional purchasers of variable rate bonds, including money market funds, have been seeking to be less dependent on financial institutions (both banks and insurers) as a source of credit support, even if provided by the most credit-worthy institutions. For example, in Citigroup's recent experience, money market funds would prefer that a "demand feature" be provided by the issuer rather than a third-party financial institution.

WVRDBs address these concerns. First, WVRDBs reduce the exposure of money market funds to banks and other financial institutions, due to the WVRDBs' "self tender" feature described below (i.e., the ability of the holder to sell the WVRDB back to the issuer). Furthermore, WVRDBs, as an alternative to traditional variable rate bonds, offer diversification benefits including the diversification of event and put risk as well as portfolio diversification.

Citigroup believes that a WVRDB should be viewed as a Long Term Variable Rate Security for purposes of paragraph (d)(3) of Rule 2a-7. Citigroup seeks the requested no-enforcement position, however, to clarify this issue for money market funds that have expressed an interest in acquiring WVRDBs.

II. Description of the WVRDBs

A. *General*

A WVRDB is a variable rate security with a nominal long-term maturity (e.g., 30 years). An issuer may offer one or more series of WVRDBs.² A WVRDB will be subject to a "dual put" feature (as described below), which will allow an investor, at its sole option, to tender a WVRDB for purchase within a fixed period of time not to exceed 397 calendar days (i.e., 13 months) in any case.³ In addition, upon notice of not less than 30 days (and not more than 60 days), a WVRDB is subject to redemption prior to its stated maturity, at the option of the issuer, in whole or in part, at a price equal to the amount of bonds called for redemption, plus accrued interest to the date of redemption, without premium.

² For purposes of simplicity, references to a "WVRDB" or "WVRDBs" in this letter refer to a WVRDB series sold by specific issuer.

³ WVRDBs currently in the market may be tendered for purchase for immediate sale, but in no case longer than seven months after the date of tender.

The interest on a WVRDB is initially set at fixed spread to SIFMA,⁴ resetting weekly. The interest is calculated based on a 365- or 366-day year for the actual days elapsed for the WVRDB and is payable monthly in arrears on the first Thursday of each month (or the next succeeding business day if any such Thursday is not a business day). At no time will any bond bear interest that is in excess of the lesser of 15% per annum and the maximum rate of interest on the bonds permitted by applicable law. Citigroup believes that upon each interest rate adjustment until the principal amount of a WVRDB can be recovered through demand, the WVRDBs can reasonably be expected to have a market value that approximates its amortized cost.⁵

The remarketing agent may, with the consent of the issuer, increase (or decrease) the spread under certain circumstances. The remarketing agent will set the spread so that the sum of the SIFMA index plus the revised spread equals the minimum interest rate which would enable the remarketing agent to sell all WVRDBs of the same series tendered for sale on the effective date of the revised spread at a price equal to the principal amount. The remarketing agent may increase the spread as of the purchase date in a Remarketing Window (as defined below), the mandatory purchase date at the end of a Funding Window following a failed remarketing (as described below) or the purchase date of a mandatory tender initiated by the issuer. The remarketing agent may decrease the spread only in the latter two scenarios so as to protect the investor—i.e. only on a date when the bonds are subject to mandatory tender. Any revised spread would apply to all WVRDBs of the same series bearing interest as of the effective date of the revised spread.

The issuer of a WVRDB will have at least an ‘A’ credit and the highest short term rating—that is, the WVRDB issuers will be among the most credit-worthy issuers.

B. The Remarketing Window

A WVRDB will have a “dual put” feature through a “Remarketing Window” and a “Funding Window.” An investor may, at its sole option at any time, tender a WVRDB for purchase by delivering an irrevocable written notice to the remarketing agent.⁶ As a

⁴ “SIFMA” means the average reset rate on tax-exempt, weekly Variable Rate Demand Notes issued by municipalities as calculated by the Securities Industry and Financial Markets Association.

⁵ See Rule 2a-7(a)(29).

⁶ The issuer of the WVRDB will enter into a Remarketing Agreement with the remarketing agent. The remarketing agent will agree to use its best efforts to remarket the bonds that have been tendered for purchase. Citigroup will act as a remarketing agent. Each WVRDB issue will have one or more remarketing agents.

consequence of the delivery of the notice, all WVRDBs of the same series will be subject to a unconditional mandatory tender for purchase at the end of the Funding Window unless all WVRDBs of the same series for which notice has been delivered have been successfully remarketed during the Remarketing Window.

After delivery by the investor of a tender notice, there is a 30-day “Remarketing Window.” During this period, the remarketing agent will seek a buyer at the existing spread or a higher spread. The spread cannot be lowered without all WVRDBs of the same series being redeemed via a mandatory tender. Thus, there is no risk of an investor being left holding something less than it bargained for.

If the remarketing agent identifies a purchaser for a WVRDB for which a notice has been delivered prior to the end of the Remarketing Window, the remarketing agent will give electronic notice to the tendering investor (as well as the other parties including the issuer) designating the purchase date, which will be no later than the last day of the Remarketing Window or, if earlier, any business day that is at least seven days after such notice is received by the tendering investor. In order to receive payment, the tendering investor must deliver the WVRDB in accordance with the procedures specified in the applicable indenture.

During the Remarketing Window, the remarketing agent will only purchase the tendered WVRDB with the remarketing proceeds. If there are insufficient remarketing proceeds, the WVRDB will not be repurchased during the Remarketing Window. The WVRDB will be returned to the investor and will continue to bear interest until such time as the bonds are purchased at the end of the Funding Window as described below. During this period, the WVRDB will continue to accrue interest under the same spread to SIFMA.

Remarketing efforts cease after the Remarketing Window closes, as the purchase date of any remarketed bond will not be later than the last day of the Remarketing Window. Citigroup believes that investors view this feature as desirable, as they believe that allowing remarketing efforts to continue would distract the issuer from focusing on the unconditional mandatory tender at the end of the Funding Window.

C. The Funding Window

If the WVRDB cannot be remarketed during the Remarketing Window, the WVRDB will enter into a “Funding Window” with an unconditional mandatory tender at the end of the Funding Window (again, in no cases longer than 397 days from date of original tender from investor). In other words, if a buyer cannot be found at the same spread, or a higher spread is not acceptable to the issuer, all WVRDBs then outstanding (not just those of the investors that provided the notice) are subject to a “hard” mandatory tender on the last day of the Funding Window. An investor will be required to deliver its

WVRDBs to the transfer agent in accordance with the procedures set forth in the indenture in order to receive payment.

If the WVRDB is not repaid by the last day of the Funding Window, the issuer will be in default and the holder will have recourse to all of the customary remedies that occur upon a default of principal or interest. Citigroup believes that this feature makes the WVRDB extremely attractive to investors as many existing investment alternatives do not offer such rigorous remedies.

Therefore, the date on which the WVRDB will be guaranteed to be sold through remarketing or repaid by the issuer is the sum of the 1-month Remarketing Window and the variable length Funding Window, but never to exceed, in aggregate, 397 days. For example, a WVRDB with a 6 month Funding Window will be repurchased no later than seven months after the date of the original investor optional tender notice (i.e., 1 month Remarketing Window plus a 6 month Funding Window). The Funding Window will never exceed 12 months, thus the maximum duration will never be more than 397 days. As discussed below, Citigroup believes that a WVRDB would be treated as having a maturity based on the remaining period until the end of the Funding Window.

We note that during the Funding Window, the issuer has several other options at its disposal, which should result in the investors being repaid before the end of the Funding Window. The issuer has the option to call the bonds at any time after appropriate notice to investors. The issuer may also convert the WVRDB to another mode under the indenture under which the bonds were issued (e.g., weekly adjustable rate) or convert the WVRDB to a new WVRDB mode at a new spread. In each case, at least 10 days advance notice will be given to investors, who will be repaid through a mandatory tender prior to the issuer exercising the desired option. At the end of the Funding Window period, if these options have not been exercised, the WVRDBs must be repaid.

LEGAL ANALYSIS

Money market funds generally invest in securities that satisfy, among other things, certain maturity and quality conditions of Rule 2a-7. With regard to quality, as discussed above, the issuer of the WVRDB will have at least an 'A' credit and the highest short term rating and, thus, a WVRDB will be, at the time of purchase by a money market fund, a First Tier Security under Rule 2a-7.

A WVRDB is designed to be treated as a "Long-Term Variable Rate Security" under paragraph (d)(3) of Rule 2a-7. A "Long-Term Variable Rate Security" is "a Variable Rate Security, the principal amount of which is scheduled to be paid in more

than 397 calendar days, that is subject to a Demand Feature.”⁷ Paragraph (d)(3) of Rule 2a-7 provides that the maturity of a “Long-Term Variable Rate Security” will be “equal to the longer of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand.” Thus, a WVRDB should generally be deemed to have a maturity equal to the period remaining until the principal amount can be recovered through the “dual put” feature, as the interest rate would be adjusting weekly.⁸

Rule 2a-7(a)(8) defines a “Demand Feature” to be “a feature permitting the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the time of exercise.” Furthermore, Rule 2a-7’s definition states that the Demand Feature must be exercisable either (i) “at any time on no more than 30 calendar days’ notice” or (ii) “at specified intervals not exceeding 397 calendar days and upon no more than 30 calendar days’ notice.”

We believe that the “dual put” feature of a WVRDB is consistent with this provision. Upon providing the remarketing notice, the remarketing agent has 30 days to remarket the WVRDB. It is the expectation of the investor, the WVRDB issuer and the remarketing agent that the WVRDB will be able to be sold within the 30 day Remarketing Window. In the event that the remarketing effort is not successful, the WVRDB will be redeemed by the issuer at the end of the Funding Period.

⁷ Rule 2a-7 defines a “Variable Rate Security” as “a security the terms of which provide for the adjustment of its interest rate on set dates (such as the last day of a month or calendar quarter) and that, upon each adjustment until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost.” Rule 2a-7(a)(29).

In addition, Rule 2a-7 defines a “Demand Feature” to be “a feature permitting the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the time of exercise. A Demand Feature must be exercisable either: At any time on no more than 30 calendar days’ notice; or At specified intervals not exceeding 397 calendar days and upon no more than 30 calendar days’ notice; or A feature permitting the holder of an Asset Backed Security unconditionally to receive principal and interest within 397 calendar days of making demand.” Rule 2a-7(a)(8).

⁸ For purposes of clarity, we want to emphasize that we would not take the view that a WVRDB with a final maturity in excess of 397 days could be treated as a Short-Term Variable Rate Security under Rule 2a-7(d)(2).

One concern that might be raised is whether the gap before the ultimate repurchase of the securities is inconsistent with the literal “30 calendar days’ notice” language of the Rule. As noted above, the WVRDB may be disposed of within 30 days after notice through the remarketing effort. In addition, assuming that the WVRDB cannot be remarketed, the exercise of the “put” has the effect of converting the WVRDB into a security with a remaining final maturity consistent with the Rule⁹ (i.e., no more than thirteen months).

The thirty day notice period appears to have been designed, in part, to address fund portfolio liquidity. When the Commission expanded the notice period from 7 days to 30 days for all types of demand features, it stated:

The Commission still believes that some limit must be placed on the extent to which funds relying on the rule will have to anticipate their cash and investment needs more than seven days in advance. However, the Commission believes that funds should be able to invest in the demand instruments that are being marketed with notice periods of up to 30 days, as long as the directors are cognizant of their responsibility to maintain an adequate level of liquidity.¹⁰

Thus, the Commission appeared to be more concerned with the certainty of receipt and not the timing of the notice.¹¹ We believe that the WVRDB structure is

⁹ We are not suggesting that it should be treated as such for purposes of Rule 2a-7(d)(2).

¹⁰ Acquisition and Valuation of Certain Portfolio Instruments by Registered Investment Companies, Investment Company Act Release No. 14983 (March 12, 1986).

¹¹ In addition, we do not believe that the WVRDB is inconsistent with a statement made in note 151 of the Commission’s release adopting the 1996 amendments to rule 2a-7. Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 21837 (March 21, 1996) (“1996 Release”). Note 151 emphasized that the amendments superseded a Staff position that had allowed funds to treat a note with a nominal one-year maturity subject to an automatic extension feature as having a one-year final maturity for purposes of the provisions of the rule governing Short-Term Variable Rate Securities. We believe that this footnote was designed to make it clear that the final maturity date of an instrument was the date on which it was scheduled to be repaid in accordance with its terms and not to state a general principal concerning the exercisability of demand features. *See* Goldman Sachs & Co., SEC No-Action Letter (August 14, 1998). (Noting that “Rule 2a-7 now requires that maturity be measured for purposes of the rule by reference to the date on which a holder is ‘unconditionally’ entitled to principal”). The 1996 change in position

consistent with this objective. We are aware that the Staff and others are concerned about money market fund liquidity.¹² Citigroup believes that money market fund managers will invest in WVRDBs only to the extent consistent with well-articulated Commission guidelines concerning portfolio liquidity.¹³ Citigroup does not believe that the “dual put” feature will reduce fund liquidity; rather, it may enhance liquidity by providing an investment which will most likely be remarketed in 30 days and which will assuredly be repurchased within seven months of notice. We are not requesting the Staff to express a view on the liquidity of a WVRDB.¹⁴

also appears to have been designed to assure that a fund treat the extension as a new acquisition of the instrument. *See id.* (discussing how each election to extend the maturity would be treated as a separate acquisition, meaning that the note would need to comply with the applicable provisions of rule 2a-7 as of the date of each extension of maturity, including the provisions relating to credit quality and diversification).

¹² *See* Andrew J. Donohue, Keynote Address at the Practicing Law Institute’s Investment Management Institute 2009 (April 2, 2009) (discussing how liquidity is one of the “twin goals” of money market funds along with capital preservation); Investment Company Institute, Report of Money Market Working Group (March 17, 2009) at 5 (discussing need for explicit liquidity requirements for money market funds).

¹³ *See, e.g.*, Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145, Investment Company Act Release No. 17452 (Apr. 23, 1990) (discussing how funds must maintain high degree of liquidity to assure that portfolio securities can be sold and the proceeds used to satisfy redemptions, how the board has ultimate responsibility to make liquidity determinations and to monitor liquidity of portfolio securities, and factors that funds should consider in determining liquidity). *See also* Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 21837 (Mar. 21, 1996); Revisions of Guidelines to Form N-1A, Investment Company Act Release No. 18612 (Mar. 12, 1992).

¹⁴ In a 1993 release proposing amendments to Rule 2a-7 generally applicable to tax exempt bond funds, the Commission provided another possible explanation for the 30-day notice period. That release suggests that the notice period was designed to provide a money market fund with a practical means for addressing a credit downgrade of a third-party demand feature provider:

Permitting a money market fund to invest in puts from one institution covering more than five percent of its assets will expose the fund to the credit quality of that institution to a

We also note that this result is not inconsistent with the spirit of Rule 2a-7. For example, in the case of an Asset-Backed Security, Rule 2a-7(a)(8) provides that a “Demand Feature” may also be “a feature permitting the holder of an Asset Backed Security unconditionally to receive principal and interest within 397 calendar days of making demand.” While a WVRDB is not an Asset-Backed Security, we believe that this provision reflects that the core objective of Rule 2a-7 is that the holder of security have assurances of repayment within 397 days.¹⁵ WVRDBs meet this objective.

Another potential issue that could be raised is whether, since an investor may begin the process of putting a WVRDB back to the issuer at any time, a WVRDB complies with the requirement that demand features that are not repayable on 30 days’ notice be exercisable “at specified intervals.” We note, however, that the holder is still in the same position as a holder of a bond subject to a demand feature that is exercisable

greater extent than rule 2a-7 otherwise generally allows under the Five Percent Diversification Test. The nature of the fund’s exposure to institutions providing puts, however, is different from its exposure to the issuer of the underlying security. When an institution providing a put is downgraded by a NRSRO, in the absence of an adverse development with respect to the issuer of the underlying security, issuers or investors generally can either put the instrument back on short notice or persuade the issuer to obtain a substitute for the downgraded institution.

Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 19959 (Dec. 17, 1993). This discussion suggests that the notice period was designed to permit, if not require, a note holder and an issuer to deal with a troubled third-party put provider in a fairly short time frame.

This rationale would not seem to apply when the demand feature is provided by the issuer itself. In the case of a WVRDB, the issuer will be required to repay the holder no later than the final date of the Funding Window—that is, the maturity date of the WVRDB under paragraph (d)(3) of Rule 2a-7. The major difference, which benefits the note holder, is that the note holder can establish this maturity date at any time (rather than only periodically) and may have the opportunity to dispose of the WVRDB sooner through the remarketing process.

¹⁵ See 1996 Release, *supra* note 11, at the paragraph accompanying n. 151 & 152 (discussing how the addition to the definition of “demand feature” for asset-backed securities was included in part to emphasize the concern for date on which there is a binding obligation to pay and not just the scheduled maturity).

every 397 days (assuming that there is a 12-month Funding Window). We also note that the Staff has shown some flexibility in approaching the “specified interval” provision.¹⁶

CONCLUSION

For the forgoing reasons, Citigroup respectfully requests that the Staff affirm that it would not recommend that the Commission take any enforcement action against a money market fund under Section 34(b) or 35(d) of the 1940 Act or Rule 22c-1 thereunder if it acquires and treats a WVRDB as a Long Term Variable Rate Security for purposes of paragraph (d)(3) of Rule 2a-7, provided that the fund complies in all other respects with Rule 2a-7, as now in effect, or may be amended in the future.

If the Staff has any comments or questions concerning this request, please contact the undersigned at (202) 383-8050 or Greg Larkin at (202) 383-8064. If the Staff is unable to concur with the conclusions set forth herein, we would appreciate the opportunity to discuss these matters with the Staff prior to the issuance of its response.

Sincerely



Kenneth J. Berman

¹⁶ See Merrill Lynch Investment Managers, SEC No-Action Letter (May 10, 2002) (addressing a preferred stock instrument that was subject to a demand feature that could be exercised only upon the occurrence of certain events, including a failed remarketing, rather than at specified intervals); Eaton Vance Management, SEC No-Action Letter (June 13, 2008) (addressing a similar preferred stock instrument to *Merrill Lynch* but where the demand feature was only available upon the occurrence of a failed remarketing). See also Donaldson, Lufkin & Jenrette Securities Corporation, SEC No-Action Letter (Sept. 23, 1994) (refusing to take no-action position where demand feature was conditional).