MGIC Indemnity Corporation

a subsidiary of MGIC Investment Corporation

November 13, 1975

Securities and Exchange Commission
Attention: Mr. Sydney H. Mendelsohn, Assistant Director
Division of Investment Management Regulation
Washington, D.C. 20549

Gentlemen:

This is in response to your recent question with respect to evaluating the units of Municipal Bond Funds whose portfolio bonds are insured, when and if any of such bonds may be in default or are threatened with default.

The default history of municipal bonds has been favorable in relation to other types of securities. Such defaults are usually corrected within five years or so. Fund portfolios of municipal bonds are highly diversified as to number of issues, credit source, geography and quality rating. Rarely does any single issue in these portfolios exceed 7 to 8% of the amount of the portfolio and the average individual holding would approximate 5% of the face amount of bonds in the Fund. Accordingly, if an issue in a Fund portfolio defaulted or was threatened with default, the impact on the secondary market or redemption price of the Fund's units is not likely to be great.

Most investors have only a portion of their investments in the units of Municipal Bond Funds. Many of these own units of several different Bond Funds to further diversify their investment in tax-exempts. It is our understanding that the average sale of Bond Fund units to investors approximates only some $20,000.

If the market price of the units of a Municipal Bond Fund was temporarily deflated as a result of default of an issue of bonds in its portfolio, it is unlikely that their holders would select this investment for liquidation in the event they found it necessary to raise funds for another purpose - they would more likely liquidate an investment they own which was not at the time deflated as to market price.

To measure the impact of a portfolio default on a holder of Fund units, let's assume: a) the average holder owned 20 units, approximately $20,000 acquisition cost; b) the Fund had a current portfolio of $20 million par value of bonds; c) the defaulted portfolio bonds amounted to $1 million principal amount and the market value of such bonds depreciated 75% to a price of 25. In such a case, the unitholder's share of the market price depreciation resulting from the default would be $750, only 3.75% of the $20,000 purchase price of his units (75% x $1,000,000 = $750,000 ÷ 20,000 = $37.50 x 20 = $750).

Municipal Bond Insurance Department

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In summary:

a) Historically, municipal bond defaults have not been numerous and have not been of long duration. Therefore, it is unlikely that a default on Fund portfolio bonds will exist or be threatened at times when a large number of unitholders may find it necessary to dispose of their units.

b) Theoretically, the cash flow protection afforded by insurance to a Fund which owns defaulted portfolio bonds could be held to have monetary value. However, there appears to be no acceptable method of ascertaining such value; this puts the Fund's evaluator in an indefensible position in trying to assign value to the insurance.

c) Because bonds liquidated from the insured portfolio of a Fund lose their insurance protection when they are sold, there appears to be no practical alternative to valuing portfolio bonds at their market price as uninsured securities - to value them otherwise for redemption purposes might penalize investors who remain as unitholders.

d) The monetary effect on a selling unitholder of valuing his Fund's portfolio bonds at their market price at a time when one of such issues was defaulted is so small that it appears not to be of consequence.

It is strongly recommended that the present procedure of evaluating units of Municipal Bond Funds, those with insured portfolios as well as those without insurance protection, at the market price of the bonds constituting the portfolio, whether or not they be defaulted or threatened with default, be continued. Adequate disclosure in the prospectus that this is the method by which bonds in a Fund's portfolio are valued should provide assurance that investors in these Funds are aware of the method that is uniformly applied among all Funds for the evaluation of portfolio bonds when and if units are sold or redeemed. If they should question the equity of this practice, they have the privilege of not buying units of a Municipal Bond Fund and of making alternative investments which better suit them.

Sincerely,

MGIC Indemnity Corporation

Frank C. Carr, Vice President

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