Dreyfus

THE DREYFUS CORPORATION

April 25, 2011

VIA EMAIL TO RULE-COMMENTS@SEC.GOV

Ms. Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: References to Credit Ratings in Certain Investment Company Act Rules and Forms
File No. S7-07-11; Release No. IC-29592 (the "Release")

Dear Ms. Murphy:

The Dreyfus Corporation ("Dreyfus") appreciates this opportunity to comment on the U.S. Securities and Exchange Commission's (the "Commission") proposed new rule, and rule and form amendments, under the Investment Company Act of 1940 (the "1940 Act") and the Securities Act of 1933 (collectively, the "Proposals"), that seek to implement directives under Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Section 939A").

Dreyfus is registered with the Commission as an investment adviser and is a subsidiary of The Bank of New York Mellon Corporation, a global financial services provider with approximately $1.17 trillion in assets under management and approximately $25 trillion in assets under custody or administration. Dreyfus currently manages approximately $590 billion in mutual fund, separate account, stable value, and securities lending cash collateral assets, including approximately $193 billion that is invested in 51 domestic money market fund portfolios that are structured within the confines of Rule 2a-7 under the 1940 Act.

Summary of Comments. We respectfully offer the following comments to the Commission's Proposals.

1. We believe the Proposals Provide a Framework for Higher Credit Risk in Money Market Funds. As we first commented in 2009, we believe that eliminating references to credit ratings in Rule 2a-7 is not in the best interests of money market funds and their shareholders, and is a curious result following a period of heightened concern for systemic risk. We believe the Proposals create more favorable conditions for increasing credit risk and "chasing yield," the latter of which should be of even greater concern over time when interest rates normalize and systemic passions naturally subside.

2. We believe the Proposals Would Reduce Portfolio Holdings Transparency and Increase Client Servicing Requirements. We believe the Proposals would expand money fund sponsors' client servicing requirements. Eliminating credit ratings references would erase a significant amount of the inherent transparency associated with a money market fund investment (as provided by the risk-limiting conditions of Rule 2a-7) and would oblige fund sponsors to compensate for that loss.

3. We Believe References to Credit Ratings in the Form N-MFP Can and Should be Retained. We respectfully request that the Commission reconsider whether Section 939A requires the Commission to propose removing references to credit ratings in the Form N-MFP. We believe that Section 939A does not require it, and we support retaining these references and disclosure items in the Form N-MFP (a) to help fulfill the expanded client servicing requirements discussed above; (b) to provide a critical tool for Commission and Staff oversight of money market fund credit quality; and (c) to perhaps even provide an industry "check" on potential yield chasing.

4. We believe the proposed definitions of First Tier Security and Second Tier Security may not provide an equivalent standard of creditworthiness to that which currently is provided for under Rule 2a-7. We believe the proposed credit quality standards associated with the First Tier Security and Second Tier Security definitions are not equivalent to, and in the case of First Tier Security, are higher than, the current standards under Rule 2a-7. We also have significant reservations with the proposed definition of Second Tier Security, and in this regard have included a brief discussion of eliminating the "tiering" of permissible investments altogether.

5. We believe the Commission's Cost-Benefit Analysis neither adequately states any benefit associated with the Proposals nor captures the various costs associated with the Proposals. We believe the Commission's cost-benefit analysis is inadequate. The Commission merely asserts the possibility of certain benefits but does not identify them, while also not identifying other material costs associated with the Proposals.

Discussion of Comments.

1. **The Proposals Provide a Framework for Higher Credit Risk in Money Market Funds.**

Estimated Impact on Proprietary Money Market Fund Management.

As a "First Tier-only" money fund manager, and we have always placed the highest emphasis on a fund manager's independent credit risk determinations as the driving force underlying money market fund management. Historically we have maintained, and over time enhanced the depth of, proprietary credit research resources that support our money market fund investment decision-making. Our credit research group independently evaluates issuers, instruments, and repo counterparties, and establishes from these evaluations a series of "approved lists" that provide the universe for investment decision-making. Our credit review process routinely excludes many top-rated issues and counterparties for investment by our money market funds. We continuously monitor our approved lists and adjust our evaluations and approvals accordingly as credit quality or other concerns arise. We do not expect the Proposals to change these investment selection, credit review, and monitoring processes.

Separately, we note for the Commission an incidental factor that influences a large percentage of money market fund portfolio management. Approximately 60% of all money market fund assets are represented in money market funds that (perhaps ironically) have been assigned either a "Principal Stability Fund Rating (PSFR)" by Standard and Poor's ("S&P") or a "Money Market Fund Rating" by Moody's or Fitch.[i] These NRSROs impose various conditions for maintaining such ratings; for example, funds that have been assigned S&P's highest 'AAAm" PSFR are not permitted to invest in A-2 rated securities at the time of investment. While neither directly applicable nor controlling of whether the Proposals are reasonable and appropriate, the commercial importance of these NRSRO ratings to money market funds[ii] should result in a significant percentage of funds (i.e., the "rated" funds) can be expected to continuing to focus on investing in the highest *rated* money market instruments (in order to maintain such ratings).

<u>Investor Protections are Derived from Industry-Wide Regulatory Limitations</u>.

Despite our assertion that we would not expect to alter our investment and credit processes if the Proposals are adopted, we maintain that the references to credit ratings in Rule 2a-7 provide an important investor protection by maintaining an industry-wide minimum, objective, credit quality standard that serves as the "floor" below the minimum credit risk determination. To a significant degree, the Rule levels the playing field among industry players, limits the potential for risky yield chasing, and provides a basic level of transparency (and thus, certainly) for investors. There is no replacement for that objective standard. The Proposals would eliminate these benefits and instead introduce new uncertainty and risk into the Rule and the money market fund industry. Even though the "minimal credit risk" determination remains controlling, the Proposals expand (without limitation) the universe of investments from which minimal credit risk determinations will be made. Ultimately, by definition, to the extent money market funds are characterized as posing systemic risk, we believe this Proposal increases that systemic risk.

We appreciate that Section 939A directs the Commission to undertake a review of its regulations for any references to or requirements regarding credit ratings that require the use of an assessment of creditworthiness of a security or money market instrument and to substitute alternative standards of creditworthiness that are appropriate for the purposes of the regulation. We are particularly sensitive to the Commission's corresponding dilemma in having to act on Section 939A when the Commission determined not to remove references to credit ratings in its 2010 amendments to Rule 2a-7. We did not support eliminating references to credit ratings in Rule 2a-7 when we commented on the proposed amendments to Rule 2a-7 in 2009, and we do not support it today. We continue to believe that the current references to credit ratings in Rule 2a-7 serve a critical investor protection function by providing a level of certainty, and establishing a minimum level of quality, to the universe of securities from which money market fund adviser's make independent "minimal credit risk" determinations.

2. <u>The Proposals Would Reduce Portfolio Holdings Transparency and Increase Client Servicing Requirements</u>.

We believe the Proposals will increase client servicing requirements for money market fund sponsors. As noted above, implementing the Proposals would make money market funds less transparent, which is another aspect of the Proposals that appears to reverse course on the Commission's past investor protection efforts in this regard.

Institutional investors (who ostensibly pose greater relative "systemic" concern to money market funds) in particular rely on the full transparency of money market fund holdings as part of the initial and ongoing due diligence related to their liquid investments, and we do not anticipate this would change despite the current regulatory focus on eliminating reliance on ratings (and, despite Rule 2a-7's seminal "minimal credit risk" determination requirement). By its terms, Rule 2a-7 now provides a level of transparency for investors by assuring them that at the time of purchase at least 97% of their portfolio's investments (or, in the case of Dreyfus, 100%) are either top-rated securities or, if unrated, are of comparable quality, as determined by the fund's board or the adviser as its delegate. As proposed, clients would only be assured that a money market fund's holdings, for example, are 100% "First Tier Securities, " which may or may not correlate with "100% top rated" securities.

Accordingly, money fund sponsors will have to identify and implement other ways to deliver this information to clients who request it, and because of concerns for "selective disclosure" of portfolio holdings, money fund sponsors will have to institutionalize alternative ways to deliver this information. Obviously, then, this will require additional work my money fund sponsors to meet these ongoing client demands. We believe, though, there is a partial solution to this result in the Form N-MFP, as more fully discussed below.

As an aside, we note that Commissioner Paredes asked at the March 2nd Open Meeting about the potential impact of the Proposals on the commercial paper market. Our response would be that the potential impact would be minimal, but that to the extent there is any negative impact, we believe it would be attributable to lower net sales of money market funds due to the reduced transparency of their portfolio holdings.

3. We Believe References to Credit Ratings in the Form N-MFP Can and Should be Retained.

The Reach of Section 939A. We do not agree that Section 939A compels the elimination of credit ratings information from the Form N-MFP. Section 939A appears intended to focus on the elimination of credit ratings references *"that require the use of an assessment of the creditworthiness of a security"* and *"to substitute in such regulations such standards of creditworthiness"* as the agency deems appropriate. By amending the definitions of Eligible Security and First Tier Security, removing the definitions of Rated Security, Unrated Security, Requisite NRSRO, and Designated NRSRO, and revising the requirements related to Securities Subject to Guarantees and Downgrades, Defaults, and Other Events, the Commission would eliminate the credit ratings references from Rule 2a-7 *"that require the use of an assessment of the creditworthiness of a security."*

In reviewing the legislative history of Section 939A, we understand that Congress intended to remove references to credit ratings from relevant laws and regulations in order *"to eliminate any sense that ratings carry a government imprimatur, and to encourage investors to perform their own analyses."*[iii] We believe Rule 2a-7 already requires money market funds *"to perform their own analyses"* and we also believe that the proposed definition changes listed immediately above should adequately further the legislative intent of Section 939A. Thus, we do not support the Commission going further and proposing to eliminate factual disclosure items from Form filing requirements.[iv]

Disclosure of NRSRO credit ratings assigned to money market instruments on the Form N-MFP has nothing to do with the use of or reliance on a credit rating. This information is merely factual in nature and, if retained in the Form, would serve two critical purposes: (a) alleviating, at least to some degree, the degree of additional clients servicing that will be associated with eliminating credit rating references from Rule 2a-7 and (b) providing the Commission with important information for overseeing money market funds.

In response, we would expect the Commission to perhaps say that the information being on the Form also implies a government imprimatur, but we would disagree and counter that the Commission continues to assign a material level of importance to credit ratings based, for example, on the discussion contained in Section II.A.1 of the Release. Moreover, in order to assess the credit quality of money market funds, we believe the Staff will find it necessary to obtain this information from fund companies directly on a periodic basis, layering on an additional information delivery burden for fund companies and an additional burden on the Staff to have to incorporate such data into its Form N-MFP information database, which it designed expressly to provide it with the information it needs to monitor money funds for systemic risk implications.

Use of the Form N-MFP to Maintain Transparency and to Facilitate Client Servicing Requirements and SEC Oversight. We offer this analysis of Section 939A because we support retaining the credit ratings-related disclosure items in the Form N-MFP as a means to facilitate the additional client servicing requirements that we anticipate will arise from adopting the Proposals (as described above). Even though the information will be aged by 60 days, we believe it will effectively communicate to shareholders (and, perhaps, to competitors as well) the credit qualities of the investments held in their money market fund portfolios.

We also support retaining credit ratings disclosures in the Form N-MFP to facilitate the Commission's data collection efforts and to assist the Commission and the Staff in its oversight of money market funds and enforcement of Rule 2a-7's eligibility and creditworthiness standards. We believe the Form provides a convenient, effective means for the SEC to obtain this information and to implement this priority that was established in 2008 and facilitated with the introduction of the Form last year. As proposed, the Staff would have to request and separately gather it, and compile it with other Form N-MFP data, which is an inefficient process.

Moreover, fund companies such as ours invested significant dollar amounts on programming to build the capability to compile the Form N-MFP's various data elements and to file it electronically with the Commission. Previously, this wide array of data was not housed in one environment, and technology had to be established to provide an efficient means to assemble and then deliver this information to the Staff and to investors.

Thus, for the reasons stated, we respectfully request that the Commission reconsider eliminating disclosure of assigned NRSRO credit ratings from the Form N-MFP.

4. **We believe the proposed definitions of First Tier Security and Second Tier Security may not provide an equivalent standard of creditworthiness to that which currently is provided for under Rule 2a-7.**

While we do not object to the proposed definition of Eligible Security, or to reliance on the minimal credit risk determination, we disagree with the statement in the Release that the proposed credit quality standards are similar to those that have been articulated by the credit rating agencies.

First Tier Security. We believe the proposed standard for a First Tier Security is higher than the current standard. The proposed definition of First Tier Security (that the issuer of an Eligible Security have *"the highest capacity to meet its short-term financial obligations"*), and the Commission's statement in the Release that it would expect an issuer of a First Tier Security *"should have an exceptionally strong ability to repay its short-term debt obligations and the lowest expectation of default"* (emphasis added), each establish a superlative standard that we believe equates with an 'A-1+' type credit quality rating.[v] Because Rule 2a-7 currently equates 'A-1+' and 'A-1'type credit ratings with a First Tier Security, we believe the proposed standard could be viewed as overly narrow and not an equivalent standard of creditworthiness (contrary to the statement made in the Cost-Benefit Analysis that the proposed amendments *"are designed to retain the same degree of credit risk limitation... as under current rule 2a-7"*).

Second Tier Security. We also believe that the proposed standard for a Second Tier Security may be higher than the current standard. The Commission stated in the Release that it would expect that an issuer of a Second Tier Security *"should have a very strong ability to repay its short-term debt obligations and a very low vulnerability to default"* (emphasis added), establishes a standard that we believe equates with an 'A-1' type credit quality rating.

To illustrate, we understand S&P to provide the following definitions for its 'A-1' and 'A-2' short-term ratings:

> ***A-1+***: *obligor's capacity to meet its financial commitment on the obligation is overwhelming*
>
> ***A-1***: *obligor's capacity to meet its financial commitment on the obligation is strong*
>
> ***A-2***: *is susceptible to adverse economic conditions however the obligor's capacity to meet its financial commitment on the obligation is satisfactory*

It appears apparent that the proposed Exceptional/Very Strong standards are higher than the plain language of S&P's 'A-1'/'A-2'ratings definitions (Strong/Susceptible-Satisfactory). A similar comparison can be made with Moody's and Fitch's ratings definitions. Thus, we do not believe that the Proposals retain a similar degree of risk limitation on as under the current rule.

Recommended Changes to the Proposed Definitions. To the extent the Commission determines to proceed with the proposed framework, with respect to a First Tier Security our preference would be to replace "highest capacity" with "at or very near the highest capacity" and that "exceptionally strong" be replaced in any associated descriptive standard with "at least a very strong ability," which would appear to better equate with A-1+ and A-1 type quality rated securities collectively. Further, our preference would be that "very strong ability" be replaced in any associated descriptive standard for Second Tier Securities with a "strong ability," again to better equate with A-2 type rated credits.

Second Tier Security: Alternate Objection to Maintaining the "Default Definition." We also are concerned that the proposed maintenance of the current "default definition" for a Second Tier Security (because of the proposal to eliminate credit rating references from the proposed definition of Eligible Security) opens up the universe of potential investments too broadly, In fact, it is this aspect of the Proposals that gives rise to the well-known concern for removing the credit ratings "floor" currently provided by Rule 2a-7.

In the Release, the Commission requested comment on whether the proposed definitions would allow money market funds to invest a large portion of their portfolios in what are currently Second Tier

Securities. Simply by the wording of the proposed definitions, it is only reasonable to predict some expansion of the universe of First Tier and Second Tier Securities into commensurately "lower rated" securities. The obvious potential risk is that, in pursuit of higher current yields, money market funds become increasingly populated with 'A-2' or lower rated securities that the adviser has deemed to be First Tier or Second Tier as defined by the Rule. However, we believe that our recommended definitions and descriptive standards would not increase this risk any further because (i) our proposed standards more closely equate with current ratings standards and (ii) more importantly, the above-described risk is associated with the elimination of credit rating references and the wide expansion of the investable universe and not in seeking to establish monikers that describe relative credit quality determinations.

Not only could the Proposal expand the universe of securities for investment by money market funds, we believe that, to the extent advisers deviate from current practices, boards could be faced with challenges of addressing, for example, 'A-2' rated securities that are deemed "First Tier" by the adviser. Of course, if fund boards instruct advisers to maintain current credit quality and review standards, we would expect that board decision-making should not change materially. Thus, the extent to which the universe of securities might expand to A-2 or lower quality securities may, in large part, depend on the oversight and direction of fund boards and their views on the extent to which advisers may deviate from current practices.

We further believe that maintaining transparency through disclosure of assigned credit ratings in Form N-MFP perhaps would provide the industry and investors with a public "check" on fund credit quality to see who may be straying outside the appropriate "field of play." Thus, in addition to fund board oversight, transparency in fund holdings may replace a significant portion of the protection lost from the credit quality "floor" that would be removed by adopting the Proposals.

<u>The Alternative of Eliminating the First Tier/Second Tier Distinction</u>. We have provided the foregoing comments based on the Commission's proposal to retain the concepts of First Tier and Second Tier Securities, based on the Commission's stated intention to "replace" existing standards of creditworthiness and "retain" degrees of risk limitation on money market funds similar to those found in Rule 2a-7 currently. However, we also understand that some commenters may support altogether eliminating the First Tier and Second Tier categories of investments and instead limiting fund investments to those that present minimal credit risks under a single but very high creditworthiness standard. Because the risk we believe is associated with the proposed definition of Second Tier Security, as articulated above, we acknowledge that this alternative could pose less systemic risk than the current proposal poses. Moreover, as a "First Tier only" fund family, it would appear (without knowing or assuming any details) that such a framework also would not alter our current investment and credit processes. It also would appear that such a framework might offer the Commission a replacement standard of creditworthiness that, to some degree, is less subjective than the current proposal.

Thus, we potentially could support such a single, "First Tier only" standard of creditworthiness, but we also believe that if the Commission is inclined to pursue this course, it should withdraw these Proposals and issue a new series of proposals requesting comment on such a framework. We believe this is necessary because adopting such a framework straight away (a) would be contrary to the Commission's stated goal of retaining similar risk limitations to those currently found in the Rule and (b) would not be supported by an associated cost-benefit analysis, which would not be the same as the one that is presented in association with the Proposals.

5. **<u>We believe the Commission's Cost-Benefit Analysis does not adequately capture the costs involved with many aspects of the Proposals</u>.**

Discussion of Benefits. We understand that when the Commission is engaged in rulemaking, the Commission must consider or determine whether an action is consistent with the public interest. In this regard, we were particularly struck by Commissioner Aguilar's question at the March 2nd Open Meeting, *"How can the Commission make a finding on this proposal if investors are being put in a more risky position as a result?"* For the reasons discussed in this letter, we believe the Commission will have great difficulty making this finding and, if that turns out to be the case, we believe the Commission should articulate the clear lack of any benefit associated with these Proposals and should seek reconsideration of the application of Section 939A to Rule 2a-7, in whole or even in part (which effort we would fully support). In other words, while we acknowledge the "default" attribution to Dodd-Frank in the Commission's cost-benefit analysis, we believe this is an insufficient basis on which to adopt these Proposals if the Commission cannot make its Section 2(c) finding.

We note that while the Commission attributes any benefit to be derived from the Proposals to Dodd-Frank, it seeks to quantify any such benefits by stating that the Proposals, as they relate to Rule 2a-7, "<u>may</u>" provide "<u>certain</u>" benefits to money market funds, but then proceeds merely to recite the Proposal and not to identify any benefits. We find this analysis insufficient to support adopting proposals that do not serve investors and may increase the overall risk of money funds.

Discussion of Costs. We note that the Commission does indicate in its discussion of "Costs" that removal of credit ratings from Rule 2a-7 may increase risk for money market fund shareholders. We commend the Commission for making this affirmative statement and for articulately describing the potential costs associated with eliminating the objective credit "floor" provided by the Rule currently, the increased likelihood of yield chasing, and the challenges to Commission oversight that the Proposals present.

However, we also believe that the Commission has not identified certain significant costs we believe are associated with the Proposals. Preliminarily, we agree that it is unlikely that our "Rule 2a-7 Procedures" would require substantial amendment, except to the extent necessary to reflect the terms of the rule amendments. However, we believe the analysis, at minimum, has not identified the following costs.

- <u>Increased Client Servicing Requirements</u>. As noted above, there will be an initial and ongoing burden to managing the lost transparency of investment holdings.

- <u>Re-programming Associated with Generating the Form N-MFP</u>. We disagree with the Commission's statements that there will be no cost associated with the proposed amendments to Form N-MFP, and that funds would actually save money in completing the Form N-MFP as a result of the amendments. To the contrary, we spent significant amounts on programming in order to be able to gather, compile, and electronically file the extensive, detailed information required by Form N-MFP, and we believe our competitors experienced similar burdens. Never before was this kind of detailed portfolio information housed in one place and readily available for downloading on a Form (that did not exist until mid-2010) to the Commission. Once a system was built, there is no cost "savings" associated with eliminating one or more data items. To the contrary, the Proposals will require additional programming costs to eliminate these data items from the Form.

6. Conclusion.

We thank the Commission again for the chance to comment on these important Proposals. If you have additional questions of us or would like to discuss any o these comments, I can be reached at (212) 922-6680 or at cardona.c@dreyfus.com. Alternatively, you also can contact John B. Hammalian, Managing Counsel, at (212) 922-6794 and at hammalian.j@dreyfus.com.

Very truly yours,

J. Charles Cardona

J. Charles Cardona, President

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[i] Approximately 48% of money market funds are "rated" funds, representing approximately 60% of assets in all money market funds.
Approximately 68% of all institutional money market funds are "rated" funds, representing approximately 83% of assets in all institutional money market funds and 55% of assets in all money market fund assets.
Source: iMoneyNet Money Fund and *Rated* Money Fund Reports (March, 2011).

[ii] Money market funds seek to obtain the highest ratings from one or more NRSROs in order to become "eligible investments" for a range of liquidity investors who otherwise would not be permitted to invest in money market funds due, e.g., to either to state law or corporate charter requirements.

[iii] See "The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title IX, Investor Protection," Congressional Research Service 7-5700; R41503 (November 24, 2010).

[iv] In this regard, we also would question the necessity of proposing the elimination of references to credit ratings in the Stress Testing section of Rule 2a-7. The fact of a credit rating downgrade and its potential impact on security prices is directly relevant to the stability of money market funds, but not relevant to the standard of the "use of an assessment of creditworthiness" as provided by Section 939A. If adopted as proposed, we would continue to stress test for this hypothetical event, but do not see the necessity of eliminating this aspect of the requirement, which would simply require funds to stress test for price declines without attributing them to a credit rating downgrade, which seems nonsensical.

[v] We understand the leading NRSRO's highest short-term credit ratings to provide the following credit risk standards:
(S&P A-1+) - an obligor's capacity...is OVERWHELMING
(S&P A-1) - an obligor's capacity....is VERY STRONG
(Moody P-1) - a SUPERIOR capacity for repayment
(Fitch F-1+) - the STRONGEST degree of assurance...
(Fitch F-1) - an assurance....only SLIGHTLY LESS THAN issues rated F-1
As such, we believe the proposed standards could be read to equate more with the (+) ratings, based on the superlative language used.