Charles Schwab Investment Management, Inc
211 Main St., San Francisco, CA 94105-1905

April 25, 2011

Via Electronic Filing

Ms. Elizabeth M. Murphy
Secretary
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, Release No. 33-9193, IC-29592, File No. S7-07-11**

Dear Ms. Murphy:

Charles Schwab Investment Management, Inc.[1] ("CSIM") appreciates the opportunity to comment on the Securities and Exchange Commission's ("Commission") request for comment on the above-referenced rule proposal (the "Proposed Amendments")[2]. The Proposed Amendments seek to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") by modifying Rule 2a-7 of the Investment Company Act of 1940, as amended (the "1940 Act"), and Form N-MFP to remove references to credit ratings issued by Nationally Recognized Statistical Rating Organizations and to establish a standard of credit-worthiness in place of a statutory reference to credit ratings. Below are our responses to questions posed by the Commission and to the specific language of the Proposed Amendments.

A. We do not believe that the proposed approach achieves the goal of retaining a degree of risk limitation on money market funds similar to the current rule.

Under the current rule, a money market fund may only invest in securities that satisfy a two prong test. First, securities generally must be rated as a First Tier Security or, in limited cases, a Second Tier Security by the required number of credit rating agencies. Second, investment advisers are required to complete an internal evaluation that the investment presents minimal credit risk to a fund. When Rule 2a-7 was originally adopted in 1983, the Commission made clear that each prong of the definition needed to be addressed and that they were different

[1] CSIM, a wholly-owned subsidiary of The Charles Schwab Corporation ("Schwab Corporation"), is registered with the Commission and serves as investment adviser to 17 registered money market funds with over $150 billion in total assets as of December 31, 2010. In all, CSIM serves as an investment adviser to 86 registered investment companies with more than $200 billion in assets under management as of December 31, 2010.

[2] *See* Reference to Credit Ratings in Certain Investment Company Act Rules and Forms, SEC Release No. IC-29592 (March 3, 2011).

determinations.[3] In other words, some securities may present minimal credit risk but have lower ratings or some securities may have the requisite ratings but not present minimal credit risk.

The Commission further stated in the 1983 release that it believed the requirement that a security have a high quality rating provided protection to money fund shareholders by ensuring input into the quality determination by an outside source.[4] As we stated in our previous comment letters to the Commission, we agree with the Commission that such a requirement is valuable to investors.[5] As part of this two prong test, credit ratings establish a third-party, objective, minimum floor of risk tolerance that is independent of an adviser's minimal credit risk determinations. Credit ratings also provide uniformity across money market funds by providing investors with a consistent terminology when describing the quality of a money market fund's investment portfolio. This makes it easier for investors to compare the safety and quality of investments held by one fund versus another.

The current ratings requirement is only the beginning of CSIM's investment analysis. If a security does not meet the ratings requirements (or, in the case of an unrated security, is not deemed to be of comparable quality), then the investment review process ends. However, if the ratings requirements are met, then an internal review is commenced to determine whether the security also presents minimal credit risk. While it establishes a valuable first filter for all money market funds, the fact that a security has received the requisite ratings has no bearing on whether it will meet CSIM's internal standard of presenting minimal credit risk. There have been many instances where CSIM has declined to purchase a First Tier Security for the Schwab money funds because CSIM determined that the security presented greater than minimal credit risk.

The Proposed Amendments retain the concept of Eligible Securities and their categorization as First Tier Securities and Second Tier Securities; however, in both cases, the reference to credit ratings is removed and the entire determination of a security's eligibility and status as a First Tier or Second Tier Security rests solely with the investment adviser's proprietary analysis.[6] Even though the proposed definition of First Tier and Second Tier

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[3] *See* Valuation of Debt Instruments and Computation of Current Price Per Share of Certain Open-End Investment Companies (Money Market Funds), SEC Release No. IC-13380 (July 18, 1983) (the "1983 Release") (stating that "[t]he Commission believes that the instrument must be evaluated for the credit risk that it presents to the particular fund at that time in light of the risks attendant to the use of amortized cost valuation or penny-rounding. Moreover, the board may look at some aspects when evaluating the risk of an investment that would not be considered by the rating services... Even if the board of directors believes that the rating service incorrectly rated the instrument too low or that because of changed circumstances the instrument is now of higher quality, this provision of the rule precludes a money market fund which is relying on the rule from investing in any rated instrument which does not have a 'high quality' rating").

[4] *See* the 1983 Release.

[5] *See* Letter from Jeffrey T. Brown, Senior Vice President, Charles Schwab & Co., Inc. to Ms. Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, dated September 5, 2008 (regarding File No. S7-19-08); and Letter from Koji Felton, Senior Vice President and Deputy General Counsel, Charles Schwab Investment Management, Inc. to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated September 4, 2009 (regarding File No. S7-11-09).

[6] The Proposed Amendments make this a board determination but we believe that most, if not all, boards would delegate this to a fund's investment adviser.

Security is similar to language that the credit rating agencies use to describe their own short-term ratings, the interpretation of the proposed definitions is subjective and individual credit risk determinations will undoubtedly vary across the industry from one investment adviser to another. Two investment advisers may look at different factors, or may place greater or lesser weight on certain factors, when making a minimal credit risk determination on the same security.

Even though the Proposed Amendments do not preclude an investment adviser from considering credit ratings as part of its minimal credit risk determination, the elimination of references to credit ratings in the definition of Eligible Security and First Tier Security may lead to more unrated security issuances in the market. Since the determination of whether a security would be an Eligible Security would be based solely on an investment adviser's subjective analysis, issuers of money market instruments would face greater uncertainty as to market acceptance for any particular issuance. In turn, this may lead some issuers to forgo the expense of obtaining a rating on their securities in the first instance. It may also create an incentive for an issuer who believes that an issuance would receive a rating that is not in the highest rating category from the ratings agencies to not pursue a rating. This unintended consequence of the Proposed Amendments would make it even more difficult to retain a degree of risk limitation on money market funds similar to the current rule.

We understand that the Dodd-Frank Act requires the Commission to review references to ratings in its rules and regulations within one year. However, the Commission may wish to consider, to the extent possible, seeking to extend the review period to ensure a robust examination of the potential impact to investors and money market funds. This extended period would allow the Commission to perform additional analysis as to how to revise the rule, including whether retention of credit ratings might be in the best interests of investors, and also to assess the impact of other newly adopted rules and regulations on money market funds, such as the reforms adopted in February 2010.

B. We believe removal of references to credit ratings from Rule 2a-7 results in a single test for determining what constitutes an Eligible Security and that the Commission should expand the definition of Eligible Security to reflect core factors that should be considered in making a determination of minimal credit risk.

As we stated in Section A above, the current two prong test is to balances the investment adviser's minimal credit risk analysis with credit analysis from an independent outside source. Removing the reference to credit ratings, however, converts a two prong test into single test, whereby determination of what constitutes an Eligible Security will be based solely on whether the investment adviser concludes that the security presents "minimal credit risks". Importantly, we do not believe that the definition of Eligible Security can be revised to reflect an additional assessment of credit risk—i.e., that a two prong test can be retained—because, in our view, there is no separate criteria the investment adviser can consider that is not already encapsulated within the concept of "minimal credit risk."[7]. Recognizing that removal of the credit ratings references

[7] For example, the definition of Eligible Security could be revised to mean a security that presents minimal credit risks and which has a "strong capacity for timely payment" or similar credit standard that is intended to mirror the current references to credit ratings. However, because the same entity—the adviser—will be making both

in Rule 2a-7 results in a single test, we believe a better approach would be to expand the definition of Eligible Security to reflect core factors that should be considered in making a determination of minimal credit risk. For example, an Eligible Security could be defined as "a security with a remaining maturity of 397 calendar days or less that the fund's board of directors determines presents minimal credit risks, which determination must include that the issuer has a strong capacity for timely payment of its financial commitments and is able to withstand adverse financial and economic changes that are reasonably likely to occur over the term of the security." This proposed approach will provide clear criteria that the investment adviser must consider when making a minimal credit risk determination, and also impose some degree of uniformity among the credit risk decisions that are made by different advisors.

C. If the Commission removes the references to credit ratings from Rule 2a-7, we believe that the Commission should also remove the references to First Tier and Second Tier Securities in the rule.

Although we believe that the references to credit ratings in Rule 2a-7 help protect investors and allows them to make more informed investment decisions, if the Commission removes the references to credit ratings in the rule, then we propose that the Commission also remove the references to First Tier and Second Tier Securities entirely from the rule. In our view the concept of First Tier and Second Tier is so closely tied to credit ratings that it would be more appropriate to adopt a single test for determining whether a money market fund could invest in a security as we have proposed above.

Furthermore, we believe that the continued inclusion in Rule 2a-7 of the concepts of First and Second Tier Securities, absent the outside measurement provided by credit ratings, could sow confusion among both investors and issuers. For instance, some investors may prefer to invest in a money market fund that only purchases First Tier Securities. Removing references to credit ratings from the definition of First Tier Security may be confusing for such investors since different money funds may purport to only invest in First Tier Securities but hold securities that other investment advisers would consider Second Tier Securities. Likewise, one investment adviser may determine that a piece of information about an issuer would warrant a downgrade from a First Tier Security while another investment adviser might not.[8]

Some may be concerned that eliminating the distinction between First Tier and Second Tier securities would allow a money market fund to invest 100% of its assets in securities that would be considered Second Tier Securities under the current rule and thus subject the money market fund to greater default risk. We believe the risk of such an outcome is mitigated by two

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determinations, we question the practical value of an additional prong. Under what circumstances would a security meet the first prong, but not the second (e.g., present minimal credit risk, but not have a "strong capacity for timely payment"), and vice versa?

[8] Under the language we have proposed in Section B, two investment advisers could still come to different determinations regarding whether a particular security is an Eligible Security but that would merely preclude one investor from purchasing the security, thus eliminating the potential confusion of the same security being reported as a First Tier or Second Tier Security by different money funds. Under the current rule, investment advisers regularly come to different determinations of what Rated Securities present minimal credit risks, so we believe this would not introduce a new issue to the investment process.

factors. First, we believe that our proposed definition of Eligible Security contains language that is somewhat more restrictive than that used by rating agencies to describe securities that fall within their top two rating categories, which is also consistent with spirit of the 2010 money market fund reform of reducing risk to money market fund investors. Second, we believe that an investment adviser already has an obligation to look at factors relating to an issuer's default risk as part of its minimal credit risks determination, regardless of whether the security is a First Tier or Second Tier Security.

Eliminating the First Tier and Second Tier categories would also eliminate the concept that a downgrade from a First Tier to a Second Tier Security constitutes a credit event, which we believe adds little value without an objective trigger impacting all money market funds in the same way, such as a change in credit rating. Under the Proposed Amendments, an Eligible Security is one that presents minimal credit risks. A Second Tier Security is defined as anything that is an Eligible Security that is not a First Tier Security and therefore is a security that presents minimal credit risks but is not a First Tier Security. Under the Proposed Amendments, in the event of a downgrade from First Tier to Second Tier, a money fund could continue to hold the security if the investment adviser determines that the security still presented minimal credit risk. If it was determined that the security no longer presented minimal credit risk, a money fund would need to dispose of the security unless the board of directors determined disposal would not be in the best interests of the fund. This is the same result as if the investment adviser determined that the security no longer presented minimal credit risk as part of its ongoing monitoring and would be captured under Item 2(a)-7(7)(ii)(B) and (C). Thus, we believe that this requirement, given the elimination of credit ratings, is redundant with the investment adviser's ongoing obligation to monitor for minimal credit risks.

D. If the Commission decides to retain the concept of First Tier and Second Tier Securities, the language used to describe what constitutes a First Tier or Second Tier Security in the Proposed Amendments should be consistent and not subject to unreasonably narrow interpretations.

1. The definition of First Tier Security could significantly limit the securities that could be considered First Tier Securities.

The proposed definition of First Tier Security is any Eligible Security "the issuer of which the fund's board of directors has determined has the highest capacity to meet its short-term financial obligations." The rule proposal goes on to state that an issuer with an "exceptionally strong ability to repay its short-term debt obligations and the lowest expectation of default" would meet this definition. We are concerned that the use of the terms "highest" and "lowest" to describe First Tier Securities could significantly narrow the universe of securities that would currently be considered First Tier Securities; if taken literally, the securities of only one issuer at any given time could be considered First Tier. Even if the terms were intended to refer to a category of issuers, there is still uncertainty as to the size of the category (e.g., the top 100 issuers or the top 1000 issuers). If the Commission decides to retain the distinction between First Tier and Second Tier Securities, we suggest First Tier Security be defined in terms of "very high" and "very low" rather than using superlatives.

2. Different language is used to substitute for the same concepts in different parts of the Proposed Amendments, which is confusing and raises interpretive questions.

The requirement that a security or issuer be rated in the top two rating categories by a credit rating agency appears in a few places in the current rule. The Proposed Amendments removes these references but in some instances uses different language to substitute for this concept. For example, under the current rule, a Second Tier Security and a security subject to a Conditional Demand Feature or any Guarantee or issuer of such security must each have a rating within the two highest short-term or long-term rating categories from at least two credit rating agencies, or, if unrated, be of comparable quality. Under the Proposed Amendments, an issuer of a Second Tier Security would satisfy the proposed standard if it has "a very strong ability to repay its short term debt obligations and a very low vulnerability to default." In contrast, the security subject to a Conditional Demand Feature or Guarantee must be "high quality and subject to very low credit risk". In both instances described above, different language is used in the Proposed Amendments as a substitute for identical language under the current rule. Is the language used by the Proposed Amendments intended to suggest that there are now two distinct standards applicable to Second Tier Securities and securities subject to Conditional Demand Features or Guarantees?

3. The Commission should remove references to credit ratings in Form N-MFP.

Regardless of whether the Commission retains the distinction between First and Second Tier Securities, we support the Commission's proposal to remove references to credit ratings from Form N-MFP.

E. If the Commission decides to retain the concept of First Tier and Second Tier Securities, the proposed criteria for triggering a reassessment of minimal credit risk in the event a security is no longer a First Tier Security or Second Tier Security is vague.

As we stated in our response in Section C above, without the objective trigger of a ratings downgrade, we believe that the proposed criteria for when an investment adviser would have to reassess whether a portfolio security is vague and subjective. Under the Proposed Amendments, if an investment adviser "becomes aware of any credible information about a portfolio security or an issuer of a portfolio security that may suggest that the security is no longer a First Tier Security or a Second Tier Security" then the investment adviser must reassess whether the security continues to present minimal credit risks. The word "suggests" is not constrained in any way by a reasonableness or likelihood standard. Will an investment adviser be held accountable for not placing more weight on one piece of information over another or for not accurately predicting the consequences of a particular event? We propose replacing the language above with "becomes aware of any credible information about a portfolio security or an issuer of a portfolio security that causes the investment adviser to determine that the security is no longer a First Tier Security or a Second Tier Security" to mitigate this possible outcome. This language also better matches the current rule, as well, since the prompt reassessment by the investment adviser as a result of a downgrade is not required until a downgrade has actually occurred.

F. We request that the Commission clarify that money market funds may still purchase long-term securities with remaining maturities that are in the range for money market fund eligibility.

Under the current rule, the definition of Eligible Security includes reference to Unrated Securities that at the time of issuance had a remaining maturity of more than 397 calendar days but that now have a remaining maturity of 397 calendar days or less. The existing definition allows a money market fund to purchase these securities if they have received ratings within the three highest long-term rating categories and meet the minimal credit risks standard. The deletion of this reference from the definition by the Proposed Amendments could be interpreted to mean that money funds are no longer allowed to purchase such securities as all specific references to these types of securities have been removed.

G. We request that the Commission provide more guidance with respect to the transition period from the current rule to the new rule.

We request that the compliance date for the final rule be at least six months from the publication of the final rule in the Federal Register. While we appreciate the Commission making clear in the rule proposal that funds would likely be able to rely on their current policies and procedures to comply with the proposed amendments, we agree with the Commission that some technical changes to such policies and procedures may be warranted. In addition, the proposal states that reliance on policies and procedures that comply with the current rule would be permissible as long as the board (or its delegate) concluded that the ratings specified in the policies and procedures establish similar standards to those proposed, and are credible and reliable for that use. At a minimum, we believe a board meeting would be necessary for a money fund's board to make the determinations described in the foregoing or to delegate such determinations to the fund's investment adviser. A six month compliance date would ensure that money market funds would be able to update their procedures without incurring the expenses associated with a special board meeting.

To make the transition as seamless as possible, we request that the Commission explicitly confirm in its final rule release that investment advisers would not necessarily be required to reassess a money market funds' investment portfolio at the time the new rule becomes effective. We believe this is consistent with the Commission's intent that the amended rule retains a similar degree of risk limitation on money market funds as with the current rule. Finally, money funds currently may have descriptions of minimal credit risk and Eligible Securities in their prospectuses and statements of additional information. We ask that the Commission confirm that changes to a money fund's disclosures related to credit ratings can be made in a filing pursuant to Rule 497 of the Securities Act of 1933, as amended.

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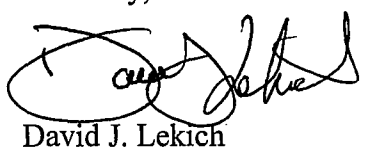
We appreciate the opportunity to comment on the Proposed Amendments and thank the Commission for its consideration of the views we express above. If you have any questions regarding this letter, please feel to contact David J. Lekich at (415) 667-0660 or Hsin Chau at (415) 667-9548.

Sincerely,



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