October 14, 2014

Mr. Kevin M. O'Neill
Deputy Secretary
Securities and Exchange Commission
100 F St., NE
Washington, DC 20549-1090

Re: **Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule, Release No. IC-31184; File No. S7-07-11**

Dear Mr. O'Neill:

Charles Schwab Investment Management, Inc. ("Schwab")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("Commission") above-referenced rule proposal (the "Proposed Amendments"). The Proposed Amendments include certain re-proposed amendments from an initial March 2011 proposal (which we originally commented on in April 2011)[2] that seek to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act by modifying Rule 2a-7 of the Investment Company Act of 1940, as amended, and Form N-MFP to remove references to credit ratings issued by Nationally Recognized Statistical Rating Organizations ("NRSROs") and to establish a standard of credit-worthiness in place of statutory reference to credit ratings. The Proposed Amendments also include a new proposal to amend Rule 2a-7's issuer diversification provisions to eliminate an exclusion from these provisions that is currently available for securities subject to a guarantee issued by a non-controlled person. Below are our responses to the Proposed Amendments as a whole, as well as to several of their particular aspects.

[1] Founded in 1989, Charles Schwab Investment Management, Inc. (CSIM), a subsidiary of The Charles Schwab Corporation, is one of the nation's largest asset management companies with $241.7 billion in assets under management as of July 31, 2014. It is among the country's largest money market fund managers and is the third-largest provider of retail index funds. In addition to managing Schwab's proprietary funds, CSIM provides oversight for the sub-advised Laudus Fund family. CSIM currently manages 76 mutual funds, in addition to two separate account model portfolios, and 21 ETF offerings.

[2] http://www.sec.gov/comments/s7-07-11/s70711-20.pdf

Executive Summary

Overall, Schwab supports the Proposed Amendments as we generally believe the Commission has struck the proper balance between not requiring entities to rely on ratings from NRSROs while at the same time allowing for their consideration when determining the credit-worthiness of securities being considered for 2a-7 fund portfolios. Furthermore, we generally support provisions of the Proposed Amendments that allow for the disclosure of NRSRO credit ratings in Form N-MFP, as we believe such disclosures will be useful to Commission staff, as well as to certain investors, in monitoring credit risk.

Despite Schwab's overall support for the Proposed Amendments, we continue to have some concerns about the proposal, as well as some recommendations for improving it, including:

- The lack of an independent floor, provided under current law by NRSRO ratings, fails to ensure some uniformity of the evaluation of credit risk across money market funds, which could potentially cause certain funds to present significantly greater risks to investors than others. That being said, the Proposed Amendments mitigate these concerns to some degree due to an improved definition of "eligible securities," the creation of a single standard for determining eligible securities, and a requirement to disclose in Form N-MFP credit ratings considered in making credit risk determinations.

- The Commission should consider amending the definition of "eligible securities" in the Proposed Amendments to better align the definition with those of the NRSRO ratings categories for first tier securities under current rules.

- We recommend that the Commission consider requiring additional disclosures of credit ratings on fund websites, in an easily digestible format, to ensure that investors have easy access to this information so as to evaluate and compare the credit risks of various money market funds.

- While we support disclosures of credit ratings considered in making credit risk determinations, these disclosures may raise practical issues that the Commission has not accounted for. For instance, NRSROs may deem inclusion of credit ratings in Form N-MFP and on fund websites as publication of the ratings, subject to additional fees beyond those imposed for simply subscribing to credit ratings research. If such disclosures are required by regulation, funds may be subject to additional costs imposed by NRSROs, whose license and publication services funds would potentially need to purchase to comply with the disclosure requirements.

- In general, Schwab is not opposed to the proposed amendments to the issuer diversification requirements, though we question the value of the proposal to remove the exemption from the 5 percent issuer diversification requirement in situations where a security is fully guaranteed. Given that in these circumstances the fund relies solely on the credit worthiness of a guarantor, and it does not appear that the proposed rules require that a credit analysis be performed on the issuer of the security, applying a diversification requirement on the issuer would seem to have little, if any, additive value.

Definition of Eligible Securities

Schwab believes that the definition of "eligible securities" in the Proposed Amendments improves upon the definition proposed in 2011 in that it reflects a single standard, eliminates the distinction between first and second tier securities, and intends to reflect a credit risk similar to that of the current rule. Use of the terminology "exceptionally strong," however, may be too limiting a standard as it is similar to language now used by NRSROs to describe the very highest quality first tier securities and could be construed as narrower than what is designated as a first tier security under the current rule.

Rather than using "exceptionally strong," we believe a more representative and appropriate standard that the Commission should consider in its place is "a very strong capacity to meet its short-term obligations." This recommended standard is sufficiently broad to capture securities that are considered eligible securities under the current rule. Moreover, the terminology is consistent with the NRSRO ratings descriptions for categories that qualify as eligible securities under the current rule.

In addition, Schwab's proposed standard would align the language used to determine the credit quality of eligible securities with that proposed for evaluating long-term obligations of conditional demand features and guarantees. Under the Proposed Amendments, eligible securities and conditional demand features are subject to potentially different standards—"exceptionally strong capacity" and "very strong capacity," respectively. This inconsistency in language could result in ambiguity as to the differences between "exceptional" and "very strong" when determining credit quality.[3]

If the Commission does not wish to revise the definition of eligible security as recommended by Schwab, we urge the Commission to clarify that the use of the term "exceptional" is intended to include securities that are comparable in credit quality to securities that fall within the two highest short-term ratings categories (i.e. those that are deemed first and second tier securities under the current rule), and is not intended to limit security selection to only those securities that are comparable in credit quality to those in the highest ratings category.

Furthermore, we request that the Commission clarify that the proposed definition of eligible security is not intended to preclude a fund from investing in an unrated security with a remaining maturity of greater than 397 days at the time of issuance, but with a remaining maturity of less than 397 days at time of purchase, provided that its long-term rating falls within the three highest long-term ratings categories, as currently permitted under Rule 2a-7(a)(12)(ii). We believe a correct reading of the proposed rule allows investments in such securities provided they meet the definition of eligible security.[4]

[3] We note under the current Rule 2a-7 framework, eligible securities and conditional demand features each must fall within the two highest short-term and long-term ratings categories, respectively.

[4] A security's long-term rating may be an additional factor a fund board considers when making a minimal credit risk determination.

Overall, Schwab believes that the relevant factors for an adviser to consider in assessing whether portfolio securities present minimal credit risk are appropriate and sufficiently clear and we do not believe that codifying these factors is necessary. In fact, codifying these factors may have the unintended negative consequence of funds only considering codified factors when it may be more appropriate to also review other pertinent factors. In addition, future changes in the markets may result in additional factors becoming more relevant over time, which could necessitate now unforeseen changes in the rule to codify new factors, if codification is pursued at this time.

Conditional Demand Features

Schwab has no significant concerns or recommendations in regards to the proposed credit quality standard for securities with a conditional demand feature. We support the proposed standard and believe the Commission was successful in retaining a similar degree of risk limitation in the proposed standard as is found in the current rule.

Monitoring Minimal Credit Risks

We believe the Commission has an accurate understanding of the manner in which funds currently monitor the credit risk of fund portfolio securities. We do not believe that most funds would experience additional costs in meeting the new monitoring requirements in the Proposed Amendments beyond those related to the initial adoption and implementation of new monitoring procedures.

Further, and in response to specific questions put forward by the Commission in the Proposed Amendments, Schwab believes that most funds are already engaged in on-going monitoring of their investments to avoid holding securities that might get downgraded to second or third tier due to events impacting the liquidity or price of the securities. Schwab does not believe that the rule should include specific objective events that would require a reevaluation of minimal credit risks as managers may limit their reviews to these triggering events, rather than truly evaluating risk on an on-going basis.

Form N-MFP

Schwab generally supports the Commission's proposal to disclose credit ratings considered in making credit risk determinations in Form N-MFP as we believe such disclosure will be useful to the SEC staff – and, to a lesser extent, certain investors – in monitoring credit risk. We think its value to investors (particularly individual investors), however, will be limited, as we don't believe many investors will access the Form disclosures on a regular basis, if at all. In addition, disclosure of credit ratings on a security-by-security basis will not give an easily digestible picture of the overall risk of the fund portfolio.

We believe, therefore, that investors would be better served if funds were required to disclose credit ratings by category in pie chart or similar form on the fund's website (i.e. in summary form by sub-category or gradation rather than on a security by security basis). We recognize that because funds may use different NRSROs to augment their credit risk

determinations, this may limit the comparability of these disclosures from fund to fund. The Commission, however, may wish to consider enhancing comparability by requiring such disclosure with regard to each NRSRO to which the fund subscribes or by requiring that a fund designate one or more NRSROs for purposes of providing this disclosure to investors.

While we believe these disclosures are important, we note one potential concern: that a fund may be required to pay additional fees to publish the ratings, as most contracts with NRSROs currently stipulate. Moreover, if funds were to be *required* to publish the ratings by regulation, and NRSROs did not waive publication fees, funds' ability to negotiate the level of fees would be significantly diminished.

Issuer Diversification Requirements

Schwab does not oppose the proposal to eliminate the exclusion from the issuer diversification requirement; however, we question the additive value of such a limit. As an initial matter, we note that complying with the issuer diversification requirement for securities that are fully guaranteed could be construed to require the manager to also conduct a credit review and on-going monitoring of the issuer as well. While we don't believe this is the intent of the Commission, we request confirmation that this is not the case.

If the Commission confirms that there is not an expectation of on-going monitoring of the issuers of guaranteed securities, then it seems counter-intuitive to require issuer diversification where the fund is not relying on the credit quality of the issuer and a determination of that issuer's credit quality is not required.

Compliance Period

Schwab believes the compliance period for the Proposed Amendments should be the later of the date proposed by the Commission (18 months after the July 2014 Money Market Fund Rule's effective date), or one year after the effective date of the Proposed Amendments. This way, if there is a considerable time lag before the Proposed Amendments are ultimately finalized, funds will still have at least one year to comply.

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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 contact David J. Lekich at (415) 667-0660.

Sincerely,

David J. Lekich
Senior Vice President and Chief Counsel
Charles Schwab Investment Management, Inc.

CC: The Honorable Mary Jo White
The Honorable Luis A. Aguilar
The Honorable Daniel M. Gallagher
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar

Norm Champ, Director
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