Scott C. Goebel
Senior Vice President
General Counsel
FMR Co.
245 Summer Street V10E, Boston, MA 02210
617.563.0371 FAX 617.385.1331 SCOTT.GOEBEL@FMR.COM

October 14, 2014

Mr. Kevin M. O'Neill, Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Submitted electronically

Re: Comments on Proposed 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) (the "Release")

Dear Mr. O'Neill:

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") on its proposed amendments to certain money market mutual fund ("MMF") rules and forms under the Investment Company Act of 1940 (the "Investment Company Act") described in the Release.[2]

Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") directs the Commission to review and identify any of its regulations that require an assessment of a security's credit-worthiness, to remove any references to credit ratings therein, and to substitute in their place a standard of credit-worthiness that the Commission deems appropriate.[3] The Commission initially proposed amendments related to the removal of references to credit ratings in March 2011 (the "2011 Proposal").[4] In the Release, the Commission re-proposes such amendments and adds a proposed amendment related to the issuer diversification provision in Rule 2a-7.

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[1] Fidelity is one of the world's largest providers of financial services, with assets under administration of over $4.9 trillion, including managed assets of over $2 trillion as of September 30, 2014. Fidelity provides investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services. We focus on meeting the unique needs of a diverse set of customers: helping 23 million people investing their own life savings, 20,000 businesses to manage their employee benefit programs, as well as providing 10,000 advisors and brokers with technology solutions to invest their own clients' money.

[2] Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule, 79 Fed. Reg. 47986 (proposed August 14, 2014), *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-08-14/pdf/2014-17746.pdf. Citations to the Commission's proposed rule are referred to herein as the "Proposed Rule(s)."

[3] Dodd-Frank Act: Pub. L. No. 111-203, 124 Stat. 1376 2010. *See* § 939A(a) and (b).

[4] References to Credit Ratings in Certain Investment Company Act Rules and Forms, 76 Fed. Reg. 12896 (proposed March 9, 2011), *available at* http://www.sec.gov/rules/proposed/2011/33-9193fr.pdf.

Fidelity recognizes the SEC staff's thoughtful approach in preparing the Release, and appreciates the Commission's effort to address the requirements of the Dodd-Frank Act, while preserving the high standards of credit-worthiness of MMFs and the securities in which they invest. Fidelity MMFs do not rely on credit ratings in making minimal credit risk determinations. We depend on an experienced research team to analyze the credit-worthiness of each issuer or security purchased by the MMFs we manage.

Fidelity's comments on the Proposed Rules, as further described in this letter, are summarized below.

- Fidelity supports removing credit rating references and eliminating the two-tier structure to credit-worthiness.
- We support the section of the Proposed Rules regarding monitoring minimal credit risk of MMF portfolio securities.
- With respect to credit quality of eligible securities, we believe that minimal credit risk is the appropriate standard and that adding additional words provides no benefit to investors.
- Regarding the proposed change to issuer diversification requirements, Fidelity urges the SEC not to implement any amendments to tax-exempt MMF diversification requirements.

I. Amendments to Rule 2a-7

Given the Dodd-Frank Act mandate to remove references to credit ratings from Rule 2a-7, the Commission should, in addition to such removal, (i) eliminate the two-tier structure to credit-worthiness, (ii) refrain from introducing a second subjective standard (e.g., "exceptionally strong capacity to meet its short-term obligations") and (iii) require MMFs to regularly monitor the credit quality of their securities. By preserving the requirement that all MMF securities represent minimal credit risk, and requiring ongoing credit quality monitoring, the Commission would ensure that shareholders can continue to expect and rely on MMFs to invest in securities with predictably high credit quality.

A. Fidelity Supports the SEC's Proposal to Eliminate the First and Second Tier Distinction

Citing various comment letters submitted to the SEC in response to the 2011 Proposal, the SEC acknowledges in the Release that the distinction between first tier and second tier securities is potentially "unworkable because of the difficulty in differentiating between first and second tier securities" in the absence of credit ratings.[5] The Commission also cites such letters in their observation that preserving the two-tier structure "would require fund boards and their advisers to apply almost indistinguishable subjective judgments in determining whether

[5] Proposed Rule at 47989.

securities were both eligible securities and first tier securities."[6] We agree with the SEC's concerns surrounding the first and second tier distinction and we support the proposed change.[7]

B. The Proposed "Exceptionally Strong Capacity to Meet its Short-Term Obligations" Standard Introduces Uncertainty Without a Corresponding Benefit

The SEC proposes in the Release that, in the absence of credit ratings, the minimal credit risk determination should include "a finding that the security's issuer has an exceptionally strong capacity to meet its short-term obligations."[8] We do not support this proposal because it would add an unnecessary standard to the minimal credit risk analysis and impose burdens on advisers without any benefit for investors. Moreover, the proposed language may not achieve the Commission's stated goal of "retain[ing] a degree of credit risk similar to that in the current rule."[9] By adding these new words to the definition of minimal credit risk, the SEC is necessarily requiring MMF advisers to limit eligible securities to only a subset of current minimal credit risk securities, which would result in a change in credit risk in some funds. Otherwise, the new language is ineffectual. If the Commission's intention is to retain the same degree of credit risk in MMFs and merely describe how advisers should approach minimal credit risk determinations, then any such commentary belongs in a final release rather than in rule text.

The current minimal credit risk determination remains the appropriate standard of credit-worthiness for MMF securities. Minimal credit risk is the highest standard applied to investment products under the Investment Company Act and MMF boards' application of that standard has served shareholders well for more than 40 years. The Commission has provided ample guidance

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[6] *Id.*

[7] As we stated in our letter in response to the 2011 Proposal, in the absence of credit rating references, the first and second tier category structure would confuse shareholders and introduce new risk to MMFs because investment advisers may interpret the categories in widely varying ways. *See*, Letter from Scott C. Goebel, Senior Vice President and General Counsel, on behalf of Fidelity Investments, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (April 28, 2011), *available at* http://www.sec.gov/comments/s7-07-11/s70711-23.pdf, at 3.

[8] Proposed Rule at 47989.

[9] *Id*. Additionally, the term "exceptional" is inapposite. "Exceptional" generally means "unusual" or "not typical." Considering the thousands of securities held by MMFs today, it does not make sense to characterize the securities in which MMFs may invest as "unusual" or "not typical." We note that the SEC recently adopted amendments to Rule 5b-3 to remove references to credit ratings pursuant to the Dodd-Frank Act. The SEC similarly stated in the adopting release to Rule 5b-3 that it sought to "retain a similar degree of credit quality to that in the rule being amended" in adopting the "exceptionally strong capacity" language for Rule 5b-3. (*See*, Removal of Certain References to Credit Ratings Under the Investment Company Act, 79 Fed. Reg. 1316 (January 8, 2014), *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-01-08/pdf/2013-31425.pdf, at 1317.) The SEC observed that the "exceptionally strong" language corresponds to the description of AAA-rated securities by Fitch and is consistent with the descriptors used by Moody's and S&P. (*Id*. at 1320.) The "exceptionally strong" language, however, is only used in the Fitch long-term credit ratings description. Prior Rule 5b-3 provided that collateral to a repo must (among other things) "be rated in the highest rating category by the Requisite NRSRO" but did not distinguish among long-term and short-term ratings. Current Rule 2a-7, by contrast, references short-term rating categories and, therefore, "exceptionally strong" is not an appropriate standard for MMF securities.

regarding minimal credit risk factors over the years, which has enhanced clarity and consistency in the application of the standard across the industry. Adding a second subjective standard of credit-worthiness is unnecessary and adds complexity to Rule 2a-7 without benefit to shareholders.[10] Reaffirming that MMF advisers must apply the minimal credit risk standard will ensure that MMFs continue to hold securities that represent a similar degree of credit risk as Rule 2a-7 currently permits.[11] Eliminating references to credit ratings will not change the meaning of "minimal credit risk" nor the manner in which MMFs apply such standard.

Adding a second credit-worthiness standard also presents operational and procedural burdens for MMFs. Requiring MMFs to analyze the meaning of a second standard, and develop and implement procedures to incorporate the standard into the credit review process, would add complexity and uncertainty to the established and successful practices that MMFs currently have in place for minimal credit risk determinations.

C. A Final Rule Release Should Clarify Elements of the SEC's Guidance Regarding Minimal Credit Risk

The SEC provides new guidance in the Release regarding its expectations of MMF boards' application of the minimal credit risk standard.[12] Fidelity believes that expanded guidance, with the changes noted below, will maintain today's degree of credit risk when credit ratings references are eliminated from Rule 2a-7. We suggest the following changes to the SEC's guidance regarding minimal credit risk factors in the Release:

1. The SEC should make clear that minimal credit risk factors are in addition to other security-level requirements set forth in Rule 2a-7.[13]

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[10] With respect to conditional demand features, we also believe that minimal credit risk is the preferable sole standard for the reasons stated herein. Fidelity recommends that the SEC should not add another standard for conditional demand features such as an issuer's or guarantor's "very strong capacity for payment of its financial commitments." Proposed revision to clause (C) of Rule 2a-7(d)(2)(iv). To facilitate transparency with regard to the credit quality of a security subject to a conditional demand feature, in Section II of this letter we recommend that MMFs should disclose ratings on underlying securities on Form N-MFP.

[11] The Commission recently deemed a single standard of minimal credit risk to be a sufficient in adopting amendments to remove credit rating references from another SEC rule. *See* Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934, 79 Fed. Reg. 1522 (January 8, 2014), *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-01-08/pdf/2013-31426.pdf.

[12] For example, in the Release the Commission suggests factors that a MMF could consider in its minimal credit risk determination. Proposed Rule at 47991-47993.

[13] For example, a security that is subject to a conditional demand feature needs to present minimal credit risk and, additionally, the conditions limiting exercise of that conditional demand feature must be remote and monitorable. Rule 2a-7(d)(2)(iv)(B). Unless otherwise noted, references in this letter to Rule 2a-7 refer to the rule as amended by the Commission in 2014. *See* Money Market Fund Reform; Amendments to Form PF, Investment Company Act 79 Fed. Reg. 47736 (August 14, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-08-14/pdf/2014-17747.pdf ("2014 Adopting Release").

2. Contrary to the bullet point in the Release regarding asset-backed securities that would suggest otherwise,[14] the valuation of underlying assets of asset-backed securities (including asset-backed commercial paper) is generally not a consideration in a minimal credit risk determination, as long as the security meets minimum collateralization levels. The bullet point should be revised to delete clause (i).

3. Repurchase agreements are approved on the basis of the credit-worthiness of the repurchase agreement counterparty along with the protections provided by certain structural features. The two bullet points in the Release regarding minimal credit risk factors for repurchase agreements[15] should be revised into a single bullet point as follows, to reflect how fund advisers analyze these securities: "For repurchase agreements under Rule 2a-7: (i) a financial analysis and assessment of the minimal credit risk of the counterparty; (ii) an assessment as to whether the haircut level is appropriate for the particular type of collateral based upon price volatility in the market for such collateral type, and (iii) a legal analysis of the protections for the money market fund provided by the terms of the repurchase agreements."

D. Fidelity Agrees with the Proposed Requirement to Monitor Minimal Credit Risk Determinations

The SEC proposes to eliminate the requirement that a MMF board (or its delegate) reassess its minimal credit risk determination with respect to a security that is the subject of certain rating downgrades, and instead to require that the board adopt written procedures to establish a process to monitor the credit quality of each portfolio security on an ongoing basis.[16] We support the proposed amendment and agree with the SEC's assertion that "most fund advisers currently engage in similar types of ongoing monitoring."[17]

Fidelity currently monitors the credit quality of MMF portfolio securities to ensure minimal credit risk of such securities in accordance with board approved policies and procedures. We believe all MMF boards, to the extent they have not already done so, should establish and periodically review a process to monitor minimal credit risk of securities held by their MMFs on an ongoing basis. Regular monitoring of the credit quality of securities enables MMFs to respond timely to credit developments, inclusive of ratings downgrades. We think this would be a prudent requirement for the MMF industry and would benefit MMF investors.

II. Fidelity Recommends that the SEC Require Additional Website Disclosure Instead of the Proposed Amendments to Form N-MFP

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[14] Proposed Rule at 47992.

[15] *Id*. at 47992-47993.

[16] *Id.* at 47995.

[17] *Id.*

In the proposed changes to Form N-MFP, the SEC appears to be attempting to address two separate concerns with one approach. First, the SEC is interested in monitoring the credit ratings of securities reported by MMFs on Form N-MFP.[18] Second, the SEC expresses the view that investors may benefit from disclosure of the credit ratings of securities held by MMFs.[19] We support both of these goals, but we do not believe that amending Form N-MFP, as proposed, is the best way to achieve them.

The Commission's proposed amendment to Form N-MFP would require each MMF to disclose any subscribed ratings for each portfolio security and any other ratings that the fund's board (or its delegate) utilizes in its minimal credit risk determination. Although this change would provide the SEC with access to credit ratings of MMF portfolio securities,[20] the requirement would not assist the Commission or fund shareholders in understanding a MMF's approach to credit quality determinations. A MMF's subscription to a credit rating agency is not a good indicator of whether a MMF has used the rating agency for credit quality evaluations because the MMF may actually put little or no weight on subscribed ratings when determining the credit-worthiness of a security. MMF advisers subscribe to ratings services for other purposes, such as to evaluate appropriate pricing levels for a particular security, to provide an additional information source for issuer and market developments, and to analyze future market access prospects of an issuer (for example, to evaluate the likelihood of success for replacement financing for bond anticipation notes or other short-term bridge debt). Even if a MMF adviser ascribes some degree of substantive weight to a security's rating, it would be difficult for a shareholder to interpret or understand the extent to which the MMF's adviser considers such rating and how that consideration may vary across different types of securities, different market sectors, and different rating agencies. Fidelity believes that requiring such disclosure would not achieve the SEC's stated goal of greater transparency,[21] but instead would lead to shareholder confusion.

As an alternative, we suggest that the Commission require each MMF to disclose information about the credit quality of its portfolio on its website. Given that ratings are a common, if imperfect, means of providing some indication of credit quality, each MMF would likely disclose (1) the rating methodology used in its disclosure, including particular rating

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[18] *Id*. at 47997.

[19] *Id*.

[20] Given the detailed security identifiers provided on Form N-MFP, the Commission could certainly subscribe to the credit rating agency data feeds and track any rating changes in that manner.

[21] *See, e.g.*, U.S. Securities and Exchange Commission Strategic Plan, Fiscal Years 2014-2017, *available at* http://www.sec.gov/about/sec-strategic-plan-2014-2018.pdf, at 38, stating as part of an initiative to accomplish "Strategic Objective 3.1: The SEC works to ensure that investors have access to high-quality disclosure materials that facilitate informed investment decision-making" that: "As technology and the complexity of financial instruments change, so too do the needs of modern day investors. Providing investors with information in concise, easy-to-use formats that are tailored to their needs helps investors to help themselves."

agencies it chooses to use for disclosure purposes,[22] and (2) a summary of the MMF's composition based on the short-term ratings for the prior period of review. This approach would allow the Commission and shareholders to review the risk profile of a MMF and to compare the risk profiles of different MMFs. It would also be consistent with the current disclosure practice of some fund advisers (including Fidelity) and would provide shareholders a straightforward way to understand assigned ratings without introducing the ambiguity inherent in "subscribed ratings" disclosure.

Additionally, with respect to securities that are subject to conditional demand features, we recommend that the SEC require that MMFs disclose the ratings on the underlying securities on Form N-MFP, in addition to the short-term ratings on the conditional demand feature itself. This would ensure that the Commission and shareholders are able to review and compare credit ratings on MMF securities that are subject to conditional demand features.

III. Fidelity Urges the SEC to Refrain from Amending Tax-Exempt MMF Diversification Requirements

Rule 2a-7 does not currently require MMFs to be diversified with respect to issuers of securities that are subject to a guarantee by a non-controlled person.[23] The SEC proposes to eliminate this exclusion from the issuer diversification provision.[24] The SEC asserts that because it is possible for an investor to be repaid from two sources (the guarantor and the issuer), the diversification requirements for MMF securities should apply to issuers as well as guarantors.[25]

Fidelity strongly recommends that tax-exempt MMFs remain excluded from issuer diversification testing. As we have described in the past, there are several reasons why municipal MMFs warrant particular consideration by the Commission.[26] Recognizing those

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[22] For example, certain Fidelity-advised bond funds currently disclose the following ratings methodology on their website: "Credit ratings for a rated issuer or security are categorized using the highest credit rating among the following three Nationally Recognized Statistical Rating Organizations ("NRSRO"): Moody's Investors Service (Moody's); Standard & Poor's Rating Services (S&P); or Fitch, Inc. If none of these three NRSROs publishes a rating, then the security is categorized as Not Rated. All U.S. government securities are included in the U.S. Government category. The table information is based on the combined investments of the fund and its pro rata share of any investments in other Fidelity funds." Of course, it is possible that a MMF would chose to disclose information about credit quality by means other than external credit ratings.

[23] Rule 2a-7(d)(3)(i).

[24] Proposed Rule at 47999.

[25] *Id*. at 47998.

[26] Letter from Scott C. Goebel, Senior Vice President and General Counsel, on behalf of Fidelity Investments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (September 16, 2013), *available at* http://www.sec.gov/comments/s7-03-13/s70313-149.pdf, at 9-15, citing portfolio construction of tax-exempt MMFs presenting a similar risk profile to government MMFs; low default rates of municipal securities; strong performance of variable rate demand notes and tender option bonds; and tax-exempt MMFs as a key source of funding to state and local governments and to non-profit organizations. An additional distinction between tax-exempt and non-tax-

differences, the SEC has appropriately tailored certain provisions of Rule 2a-7 for the particular characteristics of tax-exempt MMFs.

The Rule 2a-7 amendments that the Commission adopted in 2010 require that taxable MMFs, but not tax-exempt MMFs, hold ten percent of total assets in "daily liquid assets." In adopting an amendment that treats tax-exempt MMFs differently from taxable MMFs, the Commission acknowledged the "different nature of the markets for tax-exempt securities" and concluded that tax-exempt MMFs would be "unlikely to have investment alternatives" that would permit them to meet the requirement.[27] Fidelity believes that the supply considerations of the municipal market, cited by the Commission in 2010, provide the Commission with the basis for continuing to exclude tax-exempt MMFs from issuer diversification requirements.

Previously, Rule 2a-7 contained a diversification requirement that limited a MMF's exposure to any first tier demand feature or guarantee provider to ten percent of a MMF's total assets, but only with respect to seventy-five percent of the portfolio (thereby permitting what was referred to as the "twenty-five percent basket"). The amendments adopted by the Commission earlier this year eliminate the twenty-five percent basket for taxable MMFs and reduce it to a fifteen percent basket for tax-exempt MMFs. The Commission provided support for such differing treatment of tax-exempt MMFs by citing the "greater effect" of such changes on tax-exempt MMFs.[28] We urge the Commission to make a similar distinction between taxable and tax-exempt MMFs in this rulemaking and eliminate further changes to tax-exempt MMF diversification requirements.

Removing the issuer diversification exclusion would negatively impact the tax-exempt MMF market by causing supply challenges,[29] without resulting in a corresponding benefit to shareholders. Additionally, the issuers of these securities would face less demand and higher costs associated with capital raising efforts. We estimate that as of September 30, 2014, compliance with the SEC's proposed change would require Fidelity's tax-exempt MMFs to sell approximately $438 million par amount of municipal securities. We do not believe that this change in portfolios would benefit tax-exempt MMF shareholders.

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exempt MMFs is that some issuers of tax-exempt securities do not provide disclosure that is a satisfactory basis for a credit evaluation.

[27] *See* Money Market Fund Reform, 75 Fed. Reg. 10060 (adopted March 4, 2010), *available at* http://www.sec.gov/rules/final/2010/ic-29132fr.pdf, at 10078.

[28] *See* 2014 Adopting Release at 47883. The Commission acknowledged the "limited availability of guarantor and demand feature providers for tax-exempt money market funds as opposed to non-tax-exempt money market funds."

[29] The Commission has previously acknowledged that different diversification requirements have applied to tax-exempt MMFs due to supply constraints. *Id.* at 47738 (FN18).

We appreciate the opportunity to comment on the Proposed Rules. Fidelity would be pleased to provide any further information or respond to any questions that the SEC staff may have.

Sincerely,

Scott C Goebel

cc: The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner

Norm Champ, Director, Division of Investment Management