



1401 H Street, NW, Washington, DC 20005-2148, USA  
202/326-5800 www.ici.org

October 14, 2014

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

Re: Removal of Certain References to Credit Ratings and Amendments to the Issuer Diversification Requirement in the Money Market Fund Rule (File No. S7-07-11)

Dear Mr. O'Neill:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to offer its views on the Securities and Exchange Commission's (i) re-proposal to remove references to credit ratings of nationally recognized statistical rating organizations (NRSROs) from Rule 2a-7 and Form N-MFP under the Investment Company Act of 1940 and (ii) proposal to amend Rule 2a-7 to make the issuer diversification provisions applicable to non-controlled persons that issue securities subject to a guarantee.<sup>2</sup> Our comments and recommendations are set forth below.

### **Removal of Certain References to Credit Ratings**

In March 2011, the SEC proposed certain amendments related to the removal of credit rating references in Rule 2a-7 and Form N-MFP. The proposed amendments were a step toward effectuating provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) that call for the SEC to review any regulation that requires the use of an assessment of the credit-worthiness of a security or money market instrument and then amend such regulations to remove any

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<sup>1</sup> The Investment Company Institute (ICI) is the world's leading association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors and advisers. ICI's U.S. fund members manage total assets of \$17.2 trillion and serve more than 90 million U.S. shareholders.

<sup>2</sup> See SEC Release No. IC-31184 (July 23, 2014), 79 FR 47986 (August 14, 2014) (release).

references to, or requirement of reliance on, credit ratings and to substitute such standard of credit-worthiness as the SEC determines is appropriate.

We are pleased that, in consideration of comments received on the initial proposal, including those from ICI,<sup>3</sup> the SEC is re-proposing amendments to replace references to credit ratings in Rule 2a-7 and modify provisions in Form N-MFP that reference credit ratings.

#### Rule 2a-7

The re-proposal would affect five elements of Rule 2a-7: (i) determination of whether a security is an eligible security; (ii) determination of whether a security is a first tier security; (iii) credit quality standards for securities with a conditional demand feature; (iv) requirements for monitoring securities for ratings downgrades and other credit events; and (v) stress testing.

#### *Eligible Securities and Treatment of First Tier Securities*

The SEC's 2011 proposal would have eliminated the objective requirement that an eligible security be rated by an NRSRO or be of comparable quality while maintaining the distinction between first tier and second tier securities. First, the proposed revisions would have combined the eligible security and minimal credit risk determinations. Second, a security would be a "first tier security" (regardless of the ratings it has received from any credit rating agency) if the fund's board (or its delegate) determines that the issuer has the "highest capacity to meet its short-term financial obligations." As in the current rule, a money market fund would be required to invest at least 97 percent of its total assets in first tier securities. A second tier security would have been defined as a security that is determined to present minimal credit risk but does not satisfy the new subjective definition of "first tier security."

ICI's comment letter expressed concern that the SEC's 2011 proposed approach could be interpreted as raising the credit standards for first tier securities (because, if taken literally, the proposal did not seem to contemplate any variation in credit-worthiness among issuers of first tier securities) and lowering them for second tier securities (by permitting a fund to invest in a security that would not have qualified under the rule's current standards). Instead, we recommended that the SEC combine the two criteria and require a single, uniform, very high standard of quality (*e.g.*, securities generally comparable to securities rated in the highest short-term rating category, which would be first tier securities under the current rule).

After consideration of commenters' concerns, the re-proposal combines the two risk criteria into a single standard that is included as part of Rule 2a-7's definition of eligible security. Specifically, under the re-proposal an eligible security would be a security with a remaining maturity of 397 calendar

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<sup>3</sup> See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated April 25, 2011, available at <http://www.ici.org/pdf/25144.pdf>.

days or less that the fund's board of directors (or its delegate) determines presents minimal credit risks, which determination includes a finding that the security's issuer has an "exceptionally strong capacity" to meet its short-term obligations. Also, because the re-proposal would eliminate the distinction between first and second tier securities, the re-proposal would remove the current prohibition on funds investing more than 3 percent of their portfolios in second tier securities.

The release notes that the re-proposed determination is designed to retain a degree of credit risk similar to that in the current rule by allowing for gradations in credit quality among securities that meet a very high standard of credit quality, while limiting a money market fund's investments in second tier securities to those the fund determines do not diminish the overall high quality of the fund's portfolio. The release also states that as a practical matter, the re-proposed standard would generally preclude firms from determining that securities rated "third tier" (or comparable unrated securities) would be eligible securities under Rule 2a-7. The release clarifies that in determining whether a security presents minimal credit risks, a fund adviser could take into account credit quality determinations prepared by outside sources, including NRSRO ratings, that the adviser considers are reliable in assessing credit risk.

ICI shares the SEC's goal of "preserv[ing] a similar degree of risk limitation as in the current rule,"<sup>4</sup> while "allowing for gradations in credit quality among securities that meet a very high standard of credit quality ...."<sup>5</sup> The SEC's reference to an "exceptionally strong" capacity to pay financial obligations, however, may not be the clearest means of conveying this intent.

We understand that the SEC does not propose to refer to a "strong" capacity to repay obligations (as suggested in our previous comment letter) because at least one NRSRO uses "strong" to describe its second highest short-term rating category.<sup>6</sup> Nevertheless, we believe that there are better modifiers than "exceptionally" to use in this context. "Exceptional" implies something unusual that might be read as not including a large number of money market securities of very high credit quality.<sup>7</sup> Exceptional also is not commonly used with gradations; we do not frequently say something is more exceptional than another exceptional thing.

The SEC requests comment on whether a finding that a security's issuer has a "very strong" capacity to meet its short-term financial obligations better reflects the current limitation in Rule 2a-7. We believe it does. Indeed, we believe that use of the terminology "very strong" might better convey a very high standard of credit quality, which may nevertheless be subject to gradations. Use of "very," rather than "exceptional," also would be consistent with the re-proposed credit standard for a security underlying a conditional demand feature. This would have the benefit of making clear that the risk of

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<sup>4</sup> Release at 47990.

<sup>5</sup> Release at 47989.

<sup>6</sup> Release at 47990, n. 46.

<sup>7</sup> Common synonyms include "unique," "incomparable," and "brilliant."

default for such an underlying security should be as low as the risk of default for eligible securities generally.

The SEC correctly determined that a default on the underlying security would result in the termination of a conditional demand feature.<sup>8</sup> The termination of a conditional demand feature has much the same effect as a default on a security: the fund loses the right to recover its full principal and interest from the demand feature provider and has recourse only to a defaulted security. Given the similar consequences, the degree of risk permitted with respect to the termination of a conditional demand feature should be equivalent to the risk of default with respect to other eligible securities. The SEC could express this most clearly by using the same modifier (namely “very”) for “strong” in both provisions.

Indeed, we urge the SEC to use consistent terms to describe credit requirements throughout Rule 2a-7. The definition of “eligible security,” for example, should refer to guarantors as well as issuers (as the case may be) and the “capacity for payment of” rather than “capacity to meet” financial obligations. Similarly, it would be better for paragraph (d)(2)(iv)(C) to refer to “financial obligations” rather than “financial commitments.” Using consistent terms to describe the credit risks permitted by Rule 2a-7 will help to achieve a more consistent degree of risk in money market fund portfolios.

Finally, regardless of what modifier is used, we recommend that Rule 2a-7 expressly include a phrase that assessments of the credit quality of eligible securities may include sub-categories or gradations indicating relative standing. Rule 2a-7 currently uses this phrase in the definition of an NRSRO’s rating category, which helps facilitate an understanding that grading the relative risks of two securities does not necessarily imply that they are not both of very high credit quality.

#### *Proposed Minimal Credit Risk Factors*

Although Rule 2a-7 does not set forth any specific factors that a board (or its delegate) should consider in determining minimal credit risks, the SEC staff has observed during money market fund examinations that most advisers to these funds evaluate some common factors that bear on the ability of an issuer or guarantor to meet its short-term financial obligations. Based on these observations, as well as recommendations made by ICI’s Money Market Working Group,<sup>9</sup> the release sets forth a non-exhaustive list of factors that the SEC believes generally should be included as part of a minimal credit risk assessment. These include:

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<sup>8</sup> Rule 2a-7(a)(6) defines a “conditional demand feature” as “a demand feature that is not an unconditional demand feature.” Paragraph (a)(30) defines an “unconditional demand feature” as “a demand feature that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security ....” Therefore, a conditional demand feature is not exercisable (terminates) upon an event of default in payment of the underlying security.

<sup>9</sup> See Appendix I of the Investment Company Institute, *Report of the Money Market Working Group* (March 17, 2009), available at [http://www.ici.org/pdf/ppr\\_09\\_mmwg.pdf](http://www.ici.org/pdf/ppr_09_mmwg.pdf).

- the issuer's or guarantor's financial condition (*i.e.*, analysis of recent financial statements, including trends relating to cash flow, revenue, expenses, profitability, short-term and total debt service coverage, and leverage (including financial leverage and operating leverage));
- the issuer's or guarantor's liquidity, including bank lines of credit and alternative sources of liquidity;
- the issuer's or guarantor's ability to react to future events, including a discussion of a "worst case scenario," and its ability to repay debt in a highly adverse situation; and
- the strength of the issuer's or guarantor's industry within the economy and relative to economic trends as well as the issuer's or guarantor's competitive position within its industry (including diversification in sources of profitability, if applicable).

In addition, the release suggests that a minimal credit risk evaluation could include an analysis of whether the price and/or yield of a security is similar to that of other securities in the fund's portfolio. The release also sets forth factors that advisers may take into account when evaluating minimal credit risks of particular asset classes. These include: municipal securities; conduit securities; asset backed securities (including asset backed commercial paper); other structured securities, such as variable rate demand notes, tender option bonds, extendible bonds or "step up" securities; and repurchase agreements.<sup>10</sup>

Re-proposed Rule 2a-7 does not include the factors but the release requests comment on the factors listed above, including whether the SEC should codify the factors as part of Rule 2a-7. Although ICI supports the inclusion of general factors in the release adopting any final amendments, we do not believe that these factors should be included in Rule 2a-7. The relevant factors for assessing a security's credit risks vary by security, and may be unique to a particular type of obligation. Changes in market conditions, financing terms, laws and regulations will change these relevant factors over time. Moreover, different analysts may give factors different emphasis in their credit assessments. Codifying factors for credit assessments therefore runs the risk that some factors may become obsolete and the list of factors may become incomplete. In fact, "freezing" the factors in this manner might unintentionally result in less robust and dynamic credit assessments.

The SEC also should refrain from providing guidance in the adopting release regarding the assessment of particular types of securities. For example, in the context of repurchase agreements, the release refers to "a government agency collateralized mortgage obligation or mortgage backed security, or other nonstandardized security ...."<sup>11</sup> Agency pass-through mortgage-backed securities, in fact, are highly standardized, as are the most common tranches of agency collateralized mortgage obligations. This is an example of how a factor that would have been relevant when collateralized mortgage obligations were first introduced may become less relevant after the securities become more widely held

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<sup>10</sup> See Release at 47991-93.

<sup>11</sup> *Id.*

and traded. Given the dynamic nature of the marketplace, we believe the risk of any such guidance becoming stale and outdated outweighs its potential benefits.

Finally, we recommend that the SEC omit the phrase “worst case scenario” from the list of relevant factors. This scenario actually assesses the alternative sources of liquidity that would be available to the issuer in the event the issuer cannot draw on a back-up liquidity facility. Although alternative sources of liquidity generally should be considered when assessing the credit risk of a security, this is not the “worst case.” A default is the worst case, the risk of which is the subject of a credit assessment—not just a scenario.

#### *Conditional Demand Features*

Currently, a security subject to a conditional demand feature may be determined to be an eligible security or a first tier security if, among other things, (1) the conditional demand feature is an eligible security or a first tier security, and (2) the underlying security (or its guarantee) has received either a short-term rating or a long-term rating, as the case may be, within the highest two categories from the requisite NRSROs or is a comparable unrated security. The rule requires this analysis of both the short-term and long-term credit aspects of the demand instrument because a security subject to a conditional demand feature combines both short-term and long-term credit risks.

Under the 2011 proposal, the SEC would have removed the credit rating requirement and amended the provision to require that the fund's board (or its delegate) determine that the underlying security or any guarantee of such a security be of high quality and subject to very low credit risk. The re-proposed standard differs in phrasing to more closely parallel the required finding in the SEC's re-proposed minimal risk determination. Under the re-proposal, a fund would have to determine, as with any other short-term security, that the conditional demand feature is an eligible security. A fund's board (or its delegate) also would have to evaluate the long-term risk of the underlying security and determine that it (or its guarantor) “has a very strong capacity for payment of its financial commitments.” The release notes that this standard is similar to those articulated by credit rating agencies for long-term securities assigned the second-highest rating. It also explains that an issuer that the board (or its delegate) determines has a very low risk of default, and a capacity for payment of its financial obligations that is not significantly vulnerable to reasonably foreseeable events would satisfy the re-proposed standard. On the other hand, securities that are rated in the third-highest category for long-term ratings (or comparable unrated securities) would not satisfy the re-proposed standard for underlying securities.

As explained above, ICI supports retaining a credit requirement for securities underlying conditional demand features. We also support a standard of “very strong capacity for payment” because, as the SEC notes, it equates to very low credit risk, provided this also is the standard for eligible securities generally. In addition, to maintain consistency with the definition of an eligible security, this provision should refer to an issuer's or guarantor's “financial obligations” rather than its “financial commitments.”

*Monitoring Credit Risks*

Rule 2a-7 currently requires a money market fund board (or its delegate) promptly to reassess whether a security that has been downgraded by an NRSRO continues to present minimal credit risks, and take such action as it determines is in the best interests of the fund and its shareholders. The 2011 proposal would have required the fund's board or its delegate to reassess if it 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 or second tier security, as the case may be.

Most commenters, including ICI, asserted that the proposed standard was too vague and would be burdensome to administer. Instead, ICI and others recommended that the SEC eliminate the requirement for reassessing minimal credit risk when a security is downgraded by an NRSRO and include a general ongoing obligation to monitor the credit risks of portfolio securities, which would obviate the need for a separate requirement to identify specific triggers for reassessment. Consistent with this recommended approach, the re-proposal would require each money market fund to adopt written procedures that require the fund adviser to provide ongoing review of the credit quality of each portfolio security to determine that the security continues to present minimal credit risks.

The release notes that ongoing monitoring of minimal credit risks would include the determination of whether the issuer of the portfolio security, and the guarantor or provider of a demand feature, to the extent relied upon by the fund to determine portfolio quality, maturity, or liquidity, continues to have an exceptionally strong capacity to repay its short-term financial obligations. The review would typically update the information that was used to make the initial minimal credit risk determination and would have to be based on, among other things, financial data of the issuer or provider of the guarantee or demand feature. The release also clarifies that funds could continue to consider external factors, including credit ratings, as part of the ongoing monitoring process. The release acknowledges that a specific requirement to monitor credit risk would essentially codify the current practices of fund managers, which are already explicit (and implicit) in several provisions of the rule.

ICI continues to support acknowledging in Rule 2a-7 that money market funds must continuously monitor the credit risks of their portfolios. We recommend that the SEC improve a few technical aspects of the rule to assure that the appropriate credits are monitored. For example, clause (ii) of re-proposed paragraph (g)(3) recognizes that an assessment of a security's credit risk should sometimes be based on financial data regarding the provider of a guarantee or demand feature for the security, rather than the issuer's financial data. Clause (i) of the paragraph, however, would require a fund to monitor only "the issuer's capacity to meet its short-term financial obligations." For many

securities, it is a guarantor or demand feature provider that the fund should monitor, rather than the issuer.<sup>12</sup>

ICI also supports the aspect of the re-proposal that would require funds to maintain records of the reassessment of minimal credit risk only “at such later times (or upon such events) that the board of directors determines that the investment adviser must reassess whether the security presents minimal credit risks.”<sup>13</sup> It would not be practical for funds to update their credit records every time their adviser reviews new information or financial data, particularly when the information does not alter the determination of minimal credit risk. Moreover, the fund’s compliance personnel will test compliance with the fund’s credit procedures, including the monitoring requirements. Thus, funds should have the latitude to determine the circumstances in which documenting a reassessment of a security’s minimal credit risk would be appropriate.

Finally, insofar as the re-proposed definition of eligible security would not require an assessment of shares of other money market funds, they also should be excluded from the monitoring requirement. This would be consistent with the re-proposal’s treatment of government securities, which are excluded from the monitoring requirement.

### *Stress Testing*

The recently adopted amendments to Rule 2a-7 require funds to test their ability based on certain hypothetical events, including a downgrade of particular portfolio security positions, to maintain weekly liquid assets of at least 10 percent and to minimize principal volatility (and, for stable net asset value money market funds, the fund’s ability to maintain a stable price per share). The 2011 proposal would have replaced the reference to ratings downgrades with the requirement that money market funds stress test their portfolios for an adverse change in the ability of a portfolio security issuer to meet its short-term obligations. Commenters, including ICI, urged the SEC not to eliminate the reference to a downgrade in the stress testing conditions.

We are pleased, therefore, that in response to these comments, the SEC has re-proposed to require that money market funds stress test for an event indicating or evidencing credit deterioration of particular portfolio security positions, each representing various exposures in a fund’s portfolio. The re-proposed amendments would describe the type of hypothetical event that funds should use for testing and include a downgrade or default as examples of that type of event. Thus, the release notes that funds could continue to test their portfolios against a potential downgrade or default in addition to any other indication or evidence of credit deterioration they determine appropriate and that might adversely affect the value or liquidity of a portfolio security. The reference to downgrades in the re-proposed

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<sup>12</sup> Similarly, in some cases the assessment of a security underlying a conditional demand feature should be based on financial data regarding its guarantor, rather than its issuer. There also is an erroneous cross reference to paragraph (e)(2)(iii), which should probably be to paragraph (d)(2)(iii)(C).

<sup>13</sup> Re-proposed paragraph (h)(3).



stress-testing provision would not require any money market fund to use a credit rating, and thus comports with the requirements of Section 939A of the Dodd-Frank Act.

### Form N-MFP

With respect to each portfolio security, money market funds currently must disclose on Form N-MFP the name of each designated NRSRO for the portfolio security and the rating assigned to the security. The 2011 proposal would have eliminated items in the form that require disclosure of the ratings of the portfolio securities. In contrast, the re-proposal would require that each money market fund disclose, for each portfolio security: (i) each rating assigned by any NRSRO if the fund or its adviser subscribes to that NRSRO's services, as well as the name of the agency providing the rating; and (ii) any other NRSRO rating that the fund's board (or its delegate) considered in making its minimal credit risk determination, as well as the name of the agency providing the rating.

ICI does not believe that it would be appropriate to base a disclosure requirement on an adviser's business decision to subscribe to an NRSRO for several reasons. The fact that an adviser subscribes to an NRSRO does not imply that the adviser considers the NRSRO's rating when assessing the credit risk of every security rated by the NRSRO. In some cases, an adviser may consider the ratings of only a subset of the securities rated by the NRSRO, which may not include any eligible securities as defined by Rule 2a-7. The adviser also may decide not to review an NRSRO's rating of a particular eligible security when there are other NRSRO ratings available that the adviser considers more informative.

Further, the re-proposed disclosure requirement also would create a financial disincentive to subscribe to an NRSRO's rating service. Every new subscription would add a new Form N-MFP disclosure item for every portfolio security rated by the NRSRO. Funds would have to license a complete rating feed from the NRSRO (the expenses of which are ultimately borne by the investor) and load the data into its system for preparing the form. Additional data license expenses may deter advisers from subscribing to an NRSRO's rating service and, consequently, discourage new entrants into the rating industry.

ICI nevertheless supports disclosing NRSRO rating information generally to investors in order to facilitate their assessment of the credit quality of a money market fund's portfolio. Specifically, we recommend that the SEC amend Rule 2a-7 to require summary disclosure on a money market fund's<sup>14</sup> website of the ratings assigned to the fund's portfolio securities by one or more NRSROs identified in the fund's prospectus.<sup>15</sup> For example, a fund's prospectus might disclose that it will provide summary

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<sup>14</sup> Government money market funds should not be required to disclose any ratings information, either on their websites or in Form N-MFP.

<sup>15</sup> We are not proposing to require the fund's board of directors to designate, monitor, or evaluate NRSROs. The decision of which NRSROs to identify in the prospectus will depend on a variety of factors, including the preferences of investors and intermediaries.

rating information on its website for two NRSROs, and the fund would disclose on its website a chart or table for each NRSRO showing the percentage of portfolio securities rated in each short-term rating subcategory or gradation and the percentage not rated by the NRSRO. We believe this approach would provide investors with more effective disclosure, rather than depicting security-by-security each rating assigned by an NRSRO merely because the fund or adviser subscribes to its services and other ratings an adviser has considered in making its minimal credit risk determination.

The proposed website disclosure requirements would provide investors with readily understandable information regarding the potential credit risks taken by a money market fund. To the extent that money market funds disclose ratings from the same NRSROs, it would facilitate the comparison of the potential credit risks of these funds. Disclosure of the percentage of the portfolio invested in the second highest rating category also may limit investments in these securities, which would be consistent with the SEC's goal of maintaining the credit standards of the current rule.

Our proposed rating disclosure should comport with Section 939A of the Dodd-Frank Act, insofar as it would not require anyone to use an NRSRO's assessment of the credit-worthiness of any security or money market instrument. Any use of the disclosed rating information would remain in the investor's discretion. Providing this rating information to investors also would not require a fund's adviser to consider the ratings in making its minimal credit risk decision.

Our proposed disclosure requirements also should be more effective in providing information regarding potential credit risks than the re-proposed amendments to Form N-MFP. Specifically, providing summary ratings information on a fund's website would provide concise and consistent information to investors in a readily available format, as well as an overall view of the ratings composition of the fund's portfolio, information that an investor would find particularly useful. On the other hand, the information conveyed by the re-proposed amendments may be inconsistent, as the ratings considered by the adviser may change from time to time. An adviser may be tempted to, for example, consider only the highest ratings whenever it assesses a security's credit risk. For these reasons, we believe it would be better to require a fund to pick one or more NRSROs in advance and to disclose in summary form all of their ratings on securities held by the fund on a consistent basis.

### **Issuer Diversification Proposal**

Generally, money market funds must limit their investments in the securities of any one issuer of a first tier security to no more than 5 percent of total assets and their investments in securities subject to a demand feature or a guarantee to no more than 10 percent of total assets from any one provider. Notwithstanding the 5 percent issuer diversification provision, Rule 2a-7 does not require a money market fund to be diversified with respect to issuers of securities that are subject to a guarantee by a non-controlled person. This exclusion could allow, for example, a fund to invest a significant portion or all of the value of its portfolio in securities issued by the same entity if the securities were guaranteed

by different non-controlled person guarantors such that none guaranteed securities with a value exceeding 10 percent of the fund's total assets.

By diversifying solely against the guarantor, the release suggests that the fund could be relying on the guarantors' credit quality or repayment ability, not the issuer's. It also would create a highly concentrated portfolio that would be subject to substantial risk if the single issuer in whose securities it had invested were to come under stress or default. In consideration of the SEC's reform goal of limiting concentrated exposure of money market funds to particular economic enterprises (*i.e.*, new amendments that require money market funds to limit their exposure to affiliated groups, rather than to discrete issuers<sup>16</sup>), the re-proposal would require each money market fund that invests in securities subject to a guarantee (whether or not the guarantor is a non-controlled person) to comply with both the 10 percent diversification requirement for the guarantor as well as the 5 percent diversification requirement for the issuer. As a result, except for the special provisions regarding single-state money market funds, no money market fund non-government portfolio security would be excluded from Rule 2a-7's limits on issuer concentration.

The release's cost/benefit analysis of this proposal is based on a single sample of data from Forms N-MFP covering February 2014. The sample showed "only 8 out of 559 money market funds held securities with a guarantee by a non-controlled person that exceeded the 5 percent diversification requirement for issuers."<sup>17</sup> Based on this data sample, the SEC believes that very few money market funds rely on the issuer diversification exclusion for securities subject to a guarantee by a non-controlled person. Despite the SEC's belief, our tax exempt money market fund members have indicated that they regularly rely on the exclusion for securities guaranteed by non-controlled persons to exceed the 5 percent issuer diversification limit. We would suggest the SEC's staff review the sample to make sure that it aggregated all holdings of each issuer's securities, not just those securities subject to guarantees by non-controlled persons. In any event, we anticipate that a broader sample would reveal more frequent reliance by tax exempt money market funds on this exception.

The proposal assumes a ready supply of securities supported by the same guarantor but having different issuers, so that a fund could comply with the issuer diversification requirement without reducing its holdings of the guarantor's securities. This is not the case, however, particularly in the tax exempt market. It would be serendipitous for a fund forced to dispose of a guaranteed security to replace it with another issuer's security having the same guarantor. Repealing this exception to the issuer diversification requirement is therefore likely to both increase the number of guarantors held in a fund's portfolio (some of which may present marginally greater credit risks) and the number of unenhanced securities. In other words, the SEC's effort to increase the diversification of issuers on

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<sup>16</sup> See Rule 2a-7(d)(3)(ii)(F).

<sup>17</sup> Release at 48010.

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which a fund does not look to as the ultimate source of payment may diminish the percentage of the portfolio subject to credit enhancement and the overall credit quality of the guarantors.

ICI does not believe that such a trade-off of credit quality for nominal diversification would serve the interests of money market fund shareholders. We therefore recommend that the SEC retain the exception for securities guaranteed by non-controlled persons, at least for tax exempt money market funds. Indeed, the SEC has recognized that tax exempt money market funds should have unique treatment under Rule 2a-7 in other instances (*e.g.*, daily liquid asset requirements, diversification limit on guarantees and demand features) because these money market funds face a significantly more constrained supply of investable securities than other types of money market funds.

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We look forward to working with the SEC as it continues to examine these critical issues. In the meantime, if you have any questions, please feel free to contact me directly at (202) 218-3563 or Jane Heinrichs, Senior Associate Counsel, at (202) 371-5410.

Sincerely,

/s/ Dorothy Donohue

Dorothy Donohue  
Deputy General Counsel – Securities  
Regulation

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  
Division of Investment Management