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April 18, 2011

VIA E-MAIL RULE-COMMENTS @SEC.GOV

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

RE: Securities Industry and Financial Markets Association comments on File No S7-07-11, Release No. IC-29592 (the "Release")

Dear Ms. Murphy:

The Asset Management Group (the "AMG") of Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to submit this letter in response to the request for comments made by the Securities and Exchange Commission (the "Commission") in the Release. In the Release, the Commission proposes amendments (the "Proposals") to Rule 2a-7 (the "Rule" or "Rule 2a-7")[1] under the Investment Company Act of 1940, as amended, (the "1940 Act") to implement Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Section 939A directs certain Federal agencies, including the Commission, to review and eliminate certain references to ratings in their regulations.

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that strengthen markets and encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. This letter has been prepared by the Asset Management Group of SIFMA, the voice for the buy side within the securities industry and the broader financial markets. The leadership of the AMG is comprised primarily of Chief Operating Officers and other senior executives at asset management firms, including the largest and most influential market participants in the United States. Collectively, the members of the AMG represent over $20 trillion of assets under management. The clients of AMG member firms include, among others, registered investment companies, state and local government pension funds, universities, 401(k) or similar types of retirement funds and private funds such as hedge funds and private equity funds.

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[1] Rule 2a-7 is the money market mutual fund rule under the Investment Company Act of 1940. 17 C. F. R. 270.2a-7.

Our comments focus on four points.

- The directive in Section 939A of the Dodd-Frank Act to review regulations that require an assessment of credit-worthiness does not apply to Rule 2a-7. That Section requires the Commission to substitute a different standard in light of the purposes for which regulated entities "rely" on ratings. Rule 2a-7 does not require reliance on ratings as an assessment of creditworthiness. Indeed, Rule 2a-7 forbids such reliance.

- While we understand that the Commission feels compelled to eliminate ratings provisions in Rule 2a-7 to satisfy Section 939A of the Dodd-Frank Act, we nevertheless wish to reiterate our view that the ratings provisions in Rule 2a-7 should be retained in the Rule. These provisions benefit shareholders and serve an important purpose as a quality floor, different from ratings provisions in other regulations.

- Even if the Commission concludes that Section 939A of the Dodd-Frank Act requires removal of references to ratings in Rule 2a-7, Section 939A of the Dodd-Frank Act does not apply to Form N-MFP, which is a disclosure form, rather than a requirement for a quality assessment. Therefore, questions relating to ratings should be retained in that Form.

- If the Commission concludes that Section 939A of the Dodd-Frank Act requires elimination of references to ratings in the Rule, we support efforts to urge Congress to amend Section 939A of the Dodd-Frank Act so that it will direct regulators to require that ratings-based determinations be accompanied by additional credit risk analysis, rather than requiring removal of references to ratings. Rule 2a-7 already includes a requirement for additional risk analysis – the requirement that each security present minimal credit risks as determined by a fund's board of directors or its delegate.

1. Section 939A of the Dodd-Frank Act is not intended to require elimination of references to ratings in Rule 2a-7.

Section 939A of the Dodd-Frank Act is not intended to require elimination of references to ratings in Rule 2a-7. The Section requires review of "(1) <u>any regulation</u> issued by . . .[an] agency <u>that requires the use of an assessment of the creditworthiness</u> of a security or money market instrument; and (2) any references to or requirements in such regulations regarding credit ratings . . . [emphasis added]" The Commission must modify "such regulations" and substitute a standard "taking into account . . . the purposes for which . . .[regulated] entities will <u>rely on such standards</u>" [emphasis added]. The foregoing underlined language, read together, indicates that Section 939 was intended to address regulations where a regulated entity is required to "rely" on the credit quality assessment of rating agencies. In contrast, Rule 2a-7 does not require a fund to rely on an assessment of creditworthiness by a rating agency, and, in fact, forbids a money market fund from relying on ratings. Ratings are only a floor, providing an additional layer of protection for shareholders beyond the minimal credit risks standard. It appears that Rule 2a-7 was inadvertently swept up in the push to prevent over-reliance on credit rating agencies, because Section 939A is being interpreted over-broadly, to eliminate use of ratings where they provide an additional safeguard to fund shareholders.

The Commission explained that reliance on ratings is forbidden (which would bring Rule 2a-7 outside the purview of Section 939A) when the Commission originally adopted Rule 2a-7. The Commission stated as follows, in explaining why both the minimal credit risks test and the separate test based on ratings are included in Rule 2a-7:

> The Commission believes that both tests [minimal credit risks and ratings standard] are significant and, therefore, has retained both in the rule. The requirement that a security have a high quality rating provides protection by ensuring input into the quality determination by an outside source. However, the mere fact that an instrument has or would receive a high quality rating may not be sufficient to ensure stability. The 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.[2]

Further, eliminating references to ratings in Rule 2a-7 defeats an explicit goal of Section 939A. The Section states that in establishing a substitute credit standard, the Commission must "seek to establish, to the extent feasible, uniform standards of credit-worthiness . . ." By eliminating reference to ratings, the Commission would eliminate the element of uniformity provided by the ratings. Each adviser's individual approach to minimal credit risks analysis would hold sway for each fund.

2. References to credit ratings in Rule 2a-7 benefit money market fund shareholders and should be retained.

We understand that the Commission feels compelled to propose eliminating ratings provisions in Rule 2a-7 in response to Section 939A of the Dodd-Frank Act, despite industry opposition to similar proposals in the past.[3] However, we reiterate the strongly held view of our

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[2] See *Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds)*, Investment Company Act Release IC-13380 (July 11, 1983). In addition to requiring a separate minimal credit risks analysis, Rule 2a-7 eschews reliance on ratings in an additional respect: the Rule permits a fund to purchase unrated securities. For these securities, the investment adviser will perform the additional credit analysis otherwise performed by a rating agency.

[3] See *References to Credit Ratings in Certain Investment Company Act Rules and Forms*, Investment Company Act Release IC-29592 (March 3, 2011) at footnote 7. The SEC considered the ratings standard in Rule 2a-7 in a 2003 concept release, in a 2008 proposal to remove the ratings standard from Rule 2a-7, and again in proposed amendments to Rule 2a-7 in 2009. See *Rating Agencies and the Use of Credit Ratings Under the Federal Securities Laws*, Investment Company Act Release IC- 26066 (June 4, 2003); *References to Ratings of Nationally Recognized Statistical Rating Organizations*, Investment Company Act Release IC-28327 (July 1, 2008); and *Money Market Reform*, Investment Company Act Release IC- 28807 (June 30, 2009).

members that the ratings provisions should remain in Rule 2a-7.[4] In contrast to certain other regulations, ratings provisions in Rule 2a-7 serve as an important floor, rather than as a basis for a credit determination.

Under the current Rule, each security purchased by a money market mutual fund must present minimal credit risks as determined by the board or its delegate. Additionally, at the time each holding is acquired, it must have short-term ratings from the requisite nationally recognized statistical rating organizations of at least second tier quality, or, if unrated, be determined by the fund board or its delegate to be of comparable quality. In effect, the rating requirement creates a quality "floor," separate from and in addition to the minimal credit risks requirement.

When the Commission proposed eliminating the rating standard from Rule 2a-7 in 2009 (the "2009 Release"), the Commission noted that recent events had called into question the reliability of ratings. Nevertheless, forbidding use of ratings as a floor eliminates an important protection for money market mutual fund shareholders. The ratings floor provides an objective test for the purchase of money market securities that works well with the subjective minimal credit risks requirement of the Rule. The ratings provide a credit quality benchmark that is uniform across funds, rather than differing based on an investment manager's particular approach. By providing a quality floor, ratings help sustain the integrity of management decisions across the industry.

The 2009 Release stated that the Commission was seeking to encourage more independent credit risk analysis under Rule 2a-7 by eliminating the ratings standard. But eliminating the ratings floor would not change the amount of independent credit analysis required under the Rule today. Retaining the rating requirement will not cause investment advisers to ignore the requirement under Rule 2a-7 to perform independent credit analysis. In our experience, investment advisers are aware of this duty and take it very seriously.

Retaining the ratings floor also is consistent with the Commission's approach to risk-limiting in other aspects of the Rule. For example, the Rule imposes both an objective standard and a subjective standard to govern maturity of money market fund holdings. Maximum maturity of any security is 397 days, maximum weighted average portfolio maturity is 60 days and maximum weighted average portfolio life is 120 days (objective standards). In addition, the Rule imposes a subjective standard that the fund must maintain a dollar-weighted average portfolio maturity "appropriate to its objective of maintaining a stable net asset value per share or price per share." The maximum maturity has not prevented funds from shortening maturities where appropriate to satisfy the subjective standard. In fact, average portfolio maturities have been well within the maximums for quite some time, illustrating that an outer limit is not treated

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[4] We expressed this view in our comment on the proposed amendments to Rule 2a-7 that were adopted in 2010. See SIFMA comment letter dated September 8, 2009 on *Money Market Reform*, Investment Company Act Release IC -28807 (June 30, 2009), available at http://sec.gov/comments/s7-11-09/s71109-128.pdf.

as the sole standard. Rule 2a-7 imposes a similar two-pronged approach to liquidity requirements. The Rule imposes an objective floor on holdings of Daily Liquid Assets and Weekly Liquid Assets and an objective ceiling on Illiquid Securities (each as defined in the Rule), and also a separate subjective standard that the fund must hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions. The Commission understands that an objective standard along with a subjective standard can work together to best assure shareholder protection. The objective standard, such as a rating, is not a safe harbor.

We note that the Obama Administration's June 2009 White Paper on reform of financial markets advised the enhancement of regulation of rating agencies, but did not advocate completely eliminating the role of rating agencies in regulation. We agree with the White Paper's recommendation that the Commission should continue its efforts to strengthen the regulation of credit rating agencies, including measures to require that firms have robust policies and procedures to manage and disclose conflicts of interest and otherwise promote the integrity of the ratings process. We support the Commission's recent initiatives in this regard. We have issued our report setting forth recommendations to avoid a recurrence of the rating irregularities that occurred during 2007 and 2008.[5] These initiatives would avoid "throwing out the baby with the bathwater" insofar as ratings are concerned.

3. Section 939A of the Dodd-Frank Act does not apply to Form N-MFP, which is a disclosure form, rather than a quality assessment requirement.

Even if the Commission concludes that Section 939A applies to Rule 2a-7, we urge the Commission to permit the continued disclosure of ratings in Form N-MFP filed under Rule 30b1-7 under the 1940 Act. The Form is a disclosure document which requires disclosure of, among other things, ratings on portfolio holdings. Rule 30b1-7 is not a regulation that "requires the use of an assessment of the creditworthiness," and therefore is not covered by the requirement for Commission review in Section 939A.

The disclosure of ratings in Form N-MFP provides transparency for money market fund shareholders, as the disclosure facilitates shareholders' ability to determine whether funds are using ratings as a floor.

4. If the Commission concludes that Section 939A requires removal of ratings from Rule 2a-7, we support efforts to urge Congress to amend Section 939A so that it will direct regulators to require that ratings-based determinations be accompanied by additional credit risk analysis, rather than requiring removal of references to ratings.

[5] See "Recommendations of the Securities Industry and Financial Markets Association Credit Rating Agency Task Force" dated July 2008, available at http://www.sifma.org/issues/item.aspx?id=21391.

If the Commission concludes that Section 939A applies to Rule 2a-7, we urge the Commission to support efforts to amend Section 939A of the Dodd-Frank Act so that it would not require elimination of references to ratings in Rule 2a-7. SEC Commissioner Luis Aguilar took just such approach at the Commission's Open Meeting at which the Commission approved the Proposals. He said that the Section should be amended "to direct regulators to require that, instead of removing the reference, ratings-based determinations be confirmed by additional risk analysis."[6] In particular, citing the view of John Walsh, the Acting Comptroller of the Currency, Commissioner Aguilar recommended that "rating-based determination be confirmed by additional risk analysis in circumstances where ratings are likely to present an incomplete picture of the risks presented to an institution, or where those risks are heightened due to concentrations in particular asset classes."[7] We support such a change (if it is necessary to retain the ratings provisions in Rule 2a-7), and we note that Rule 2a-7 already includes such additional risk analysis requirement – the minimal credit risks standard which applies to each portfolio security.

Section 939A provides the Commission an opportunity to report to Congress on the Commission's interpretation of Section 939A or on the possible recommendation of an amendment to Section 939A. Specifically, the Section requires the Commission to "transmit a report to Congress containing a description of any modification of any regulation" the Commission has made pursuant to the Section.[8]

Conclusion

SIFMA respectfully urges the Commission to consider carefully the foregoing comments regarding the Release, as SIFMA believes that eliminating references to ratings in Rule 2a-7 and Form N-MFP is not in the best interests of money market fund shareholders, would create additional risks and would not result in any benefits. A careful interpretation of Section 939A, or an amendment to that Section, would allow retention in Rule 2a-7 of an important protection for shareholders.

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[6] See statement by Commissioner Luis Aguilar, *Statement at Open Meeting: Allow the Regulators to Regulate* (March 2, 2011) available at http://sec.gov/news/speech/2011/spch030211laa-ratings.htm

[7] Id. and see Testimony of John Walsh before the Senate Committee on Banking, Housing, and Urban Affairs, September 30, 2010, available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=bfae9142-8caf-465d-b473-a04fecd13f3a

[8] We note that the Dodd-Franks Act does not set a deadline for the Commission's modification of its regulations or its transmission of the report to Congress. (Section 939A sets a deadline only for the review of regulations by the SEC (one year after the date of the enactment of the Dodd-Frank Act).) Accordingly, Section 939A allows time for the Commission to consult with Congress and for Congress to react to the Commission's report. If the Commission interprets Section 939A to require that the Commission modify Rule 2a-7 prior to transmitting the report to Congress, we recommend that any modification to Rule 2a-7 which eliminates ratings be adopted with a suspended effective date, so that Congress will have the opportunity to reconsider the scope of application of Section 939A before the modification becomes effective.

If you have any questions or require additional information, please do not hesitate to contact me at 212-313-1389. Thank you for your attention to these comments.

Sincerely,

Timothy W. Cameron
Managing Director
SIFMA's Asset Management Group

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
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