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October 14, 2014

*Filed Electronically*

Mr. Kevin M. O'Neill, Deputy Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
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 (File No. S7-07-11)

Dear Mr. O'Neill:

We appreciate the opportunity to provide our comments to the Securities and Exchange Commission (the "Commission" or "SEC") on the proposal to remove credit ratings from Rule 2a-7.<sup>1</sup> Vanguard is an SEC-registered investment adviser that has managed money market mutual funds for over 30 years.<sup>2</sup> On behalf of our shareholders, who currently invest over \$170 billion in our money market funds, we are deeply committed to working with the Commission to seek regulatory solutions that will increase investor protection and strengthen the investment standards of the \$2.6 trillion<sup>3</sup> money market fund industry. While we continue to believe that credit ratings are an effective tool in establishing a minimum standard of credit quality for money market fund securities, we submit these comments to provide the Commission with an alternative approach to defining "minimal credit risk."

As Vanguard has stated previously,<sup>4</sup> we believe that credit ratings provide a valuable, independently established baseline for money market fund investments. The Dodd-Frank Act requires the Commission to replace credit ratings with "to the extent feasible, uniform standards of credit-worthiness."<sup>5</sup> We believe the Commission's proposed credit standard may not adequately replace this baseline and, therefore, fails to

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<sup>1</sup> In *Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule*, SEC Release No. IC-31184 (July 23, 2014) (the "Proposing Release"), the Commission proposed various changes to implement provisions of Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that call for the modification of Commission regulations containing credit rating references. This comment letter will focus specifically on the elimination of credit rating references in Rule 2a-7 and related rules and forms.

<sup>2</sup> Vanguard offers more than 170 U.S. mutual funds with aggregated assets of approximately \$2.7 trillion.

<sup>3</sup> See Investment Company Institute, *Money Market Mutual Fund Assets* (October 9, 2014), available at [http://www.ici.org/research/stats/mmj/mm\\_10\\_09\\_14](http://www.ici.org/research/stats/mmj/mm_10_09_14).

<sup>4</sup> See, e.g., Vanguard Comment Letter, *References to Credit Ratings in Certain Investment Company Act Rules and Forms*, File No. S7-07-11 (April 26, 2011) ("Vanguard 2011 Comment Letter"); Vanguard Comment Letter, *Proposed Rules Regarding References to Ratings of Nationally Recognized Statistical Ratings Organizations*, File No. S7-19-08 (August 1, 2008).

<sup>5</sup> Dodd-Frank Act, Section 939A(b).

achieve the stated goal of Congress. The replacement of the minimum, objective floor for eligibility under Rule 2a-7 with a subjective standard has the potential to create different standards of credit-worthiness. As a result, we urge the Commission to consider other alternatives, such as the one set forth in this letter, that may more effectively replace the objective standard provided by credit ratings and achieve Congress's goal of uniformity.

Vanguard proposes that the Commission combine the "eligible securities" standard with the "first tier" standard to create one high credit quality standard for all money market securities. The Commission should indicate that only those securities that would currently be assigned ratings in the highest short-term category (allowing for gradations or sub-categories within that category) by a nationally recognized statistical rating organization ("NRSRO") would generally be expected to fall within this band.

Finally, we believe the Commission should provide guidance in the adopting release explaining what factors it plans to review to ensure that money market funds are adhering to the new standard. With respect to the proposed amendments relating to the use of credit ratings in stress testing, disclosure of credit ratings in Form N-MFP, and the exception from issuer diversification testing for securities with a guarantee from a non-controlled person of the issuer, we concur with the recommendations set forth in the comment letter of the Investment Company Institute.<sup>6</sup>

#### **I. The Proposed Amendments Fail to Establish a Uniform Standard of Credit-Worthiness**

Credit ratings, while imperfect, at least ensure baseline uniformity across the industry. In the absence of retaining credit ratings in Rule 2a-7, we agree with the Commission's proposal to adopt a consolidated standard for eligibility; however, we believe that the proposal does not do enough to ensure an appropriate uniform standard. The Commission believes that the proposed standard will generally limit money market funds to the same universe of securities as under the current rule.<sup>7</sup> We disagree. The proposed subjective standard, by its nature, permits an advisor to reach a minimal credit risk determination on a new, expanded universe of securities.

If adopted as proposed, the amendments to Rule 2a-7 could result in disparate eligibility standards for money market securities across the industry. The lack of uniformity will ultimately leave investors exposed to varying levels of risk and, therefore, will fail to achieve the stated goal. Vanguard instead urges the Commission to consider other alternatives, such as the one set forth below, that may more effectively replace the objective standard provided by credit ratings and achieve Congress's goal.

#### **II. The Commission Should Adopt a Standard for Eligibility that Effectively Eliminates Investments by Money Market Funds in Second Tier Securities**

Vanguard proposes that the Commission create one high credit quality standard for all money market securities. The Commission should indicate that only those securities that would currently be assigned ratings in the top short-term category (allowing for gradations or sub-categories within that category) by an NRSRO

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<sup>6</sup> See Investment Company Institute Comment Letter (October 14, 2014).

<sup>7</sup> Proposing Release at 14.

would generally be expected to fall within this definition. The practical result would be the elimination of second tier securities from money market funds.

Vanguard has supported the elimination of second tier securities in the past.<sup>8</sup> Quite simply, the acquisition of second tier securities introduces greater risks into funds and is not necessary to manage even the largest money market funds. We believe that if the current ratings floor must be removed from Rule 2a-7, a combined and enhanced single eligibility standard would most effectively help prevent money market funds from holding anything less than the highest-quality securities. We believe our proposed standard is more likely to temper aggressive credit analysis than the Commission's proposed standards.

Regardless of which new subjective standard is adopted, the Commission should provide guidance in the adopting release about what factors it plans to review to ensure that money market funds are adhering to the new standard. We believe that the Commission could ensure that funds adhere to the standard by, among other things, monitoring fund performance. For example, the Commission may monitor yields to identify "outlier" funds that may be purchasing lesser-quality securities.

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We appreciate the opportunity to comment on the Commission's proposal. If you have any questions about Vanguard's comments or would like any additional information, please contact Laura Merianos, Principal, at (610) 669-2627, or Alexander F. Smith, Associate Counsel, at (610) 669-7310.

Sincerely,

/s/ Gregory Davis  
Global Head of Fixed Income  
Vanguard

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

Norm Champ, Director, Division of Investment Management

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<sup>8</sup> See, e.g., Vanguard 2011 Comment Letter; Vanguard Comment Letter, *Money Market Fund Reform*, File No. S7-11-09 (August 19, 2009) at 1.