



October 14, 2014

VIA E-MAIL RULE-COMMENTS @SEC.GOV

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

RE: Securities Industry and Financial Markets Association comments on
Securities and Exchange Commission File Number S7-07-11, Release No. IC-31184
Removal of Certain References to Credit Ratings and Amendment to the Issuer
Diversification Requirement in the Money Market Fund Rule (the "Release")

Dear Mr. O'Neill:

The Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide our comments to the Securities and Exchange Commission (the "Commission" or "SEC") on the proposed amended rules and forms relating to money market funds in the Release.

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. These companies are engaged in communities across the country to raise capital for businesses, promote job creation and lead economic growth. This letter has been prepared by the Asset Management Group ("AMG") of SIFMA and the Private Client Group ("PCG") of SIFMA. AMG is the voice for the buy side within the securities industry and the broader

financial markets.¹ SIFMA's PCG is composed of private wealth management professionals who are dedicated to providing personalized investment advice to retail investors.²

The SEC has issued the proposals to eliminate references to ratings from Rule 2a-7 (the "Rule" or "Rule 2a-7") and to modify Form N-MFP ("Form N-MFP") under the Investment Company Act of 1940 in order to implement Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). That Section requires each federal agency to "review any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument and any references to or requirements in such regulations regarding credit ratings."³ The section further provides that each such agency shall "modify any such regulations identified by the review... or any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations."⁴

To implement this requirement, the Commission, among other things, has:

- proposed to amend the definition of "Eligible security" in Rule 2a-7 to eliminate references to ratings;
- provided commentary in the Release on the meaning of the amended definition;
- proposed to replace a requirement in the Rule to reassess securities upon downgrade with a requirement that the adviser perform ongoing review of whether each security presents minimal credit risks;
- provided guidance in the Release on some possible elements of a minimal credit risks analysis; and
- proposed criteria which may limit the ratings on portfolio securities which a money market fund must report on Form N-MFP.

¹ AMG is comprised of asset management firms, including some of the largest and most influential money market fund managers in the United States, collectively, with assets under management exceeding \$30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds.

² PCG represents wealth management professionals at global, national, regional, independent contractor, and small firms. The PCG is committed to providing proactive guidance and recommendations to enhance investor trust and confidence in the securities industry and to provide regulators and policy makers with a business perspective on legislative and regulatory proposals affecting individual investors.

³ Pub. L. No. 111-203, section 939A(a)(1)-(2).

⁴ Pub. L. No. 111-203, section 939A(b).

Separately, the SEC has proposed to eliminate an existing exception from issuer diversification testing for money market funds. Rule 2a-7 currently requires each money market fund to limit exposure to each issuer of securities in its portfolio generally to no greater than 5% of total assets, subject to certain exceptions. Under one of the exceptions, a money market fund need not test its exposure to an issuer of a security that has a guarantee issued by a non-controlled person of the issuer of the security. Under the proposals, the exception would be eliminated and a money market fund would be required to test exposure to the issuer of a guaranteed security.

We are providing the following six main comments on the proposals, each of which is described further below:

- The Commission should revise the proposed definition of “Eligible security” to eliminate the new phrase “which determination [of minimal credit risks] must include a finding that the security’s issuer has an exceptionally strong capacity to meet its short-term financial obligations.”
- The Commission should eliminate its cross-reference in the proposed Rule to commentary in the Release on the definition of “Eligible security” which conflicts with Section 939A of the Dodd-Frank Act.
- The Commission should clarify the expected frequency of review under the proposed requirement that the adviser provide ongoing review of whether each security (other than a government security) continues to present minimal credit risks.
- The Commission should reiterate in the adopting release that its commentary on minimal credit risk analysis provides a permissive, not mandatory, list of factors, and is not intended as an exhaustive list of factors required in a minimal credit risk determination.
- The Commission should eliminate the requirement to report on Form N-MFP ratings assigned to each security.
- The Commission should retain in Rule 2a-7 the exception from issuer diversification testing for securities with a guarantee from a non-controlled person of the issuer.

1. The Commission should revise the proposed definition of “Eligible security” to eliminate the new phrase “which determination [of minimal credit risks] must include a finding that the security’s issuer has an exceptionally strong capacity to meet its short-term financial obligations.”

Currently, the quality standards of Rule 2a-7 include two main tests: first, each security must present minimal credit risks, and second, each security must be an Eligible security based on ratings in the top two short-term categories (or must be an unrated security of comparable

quality). The Commission proposes to eliminate the second test, and replace it with a requirement that the determination of minimal credit risks “must include a finding that the security’s issuer has an exceptionally strong capacity to meet its short-term financial obligations.”

Our members object to the new language. The Dodd-Frank Act does not require new language to be added in this case. Rather, the Dodd-Frank Act requires the Commission to “substitute in . . . regulations [that include reliance on or reference to credit ratings] such standard of credit-worthiness as . . . [the Commission] shall determine as appropriate for such regulations.” Rule 2a-7 already includes an appropriate standard of creditworthiness – specifically, each security must present minimal credit risks. The minimal credit risks standard has served well to ensure appropriate levels of credit risk in money market fund portfolios. Also, the standard is understood in the industry, as it has been the subject of commentary, including advice by the SEC staff,⁵ a best practices report by an industry trade group⁶ and extensive explanation in the Release itself.

We understand that the Commission may intend the new standard to replicate the “floor” provided by an external ratings standard, to prevent an adviser from investing in an issuer that poses inappropriate credit risk based on an outlier credit analysis. However, the proposed language does not serve that purpose for at least two reasons. First, a new subjective standard is not an effective floor, because the subjective standard is susceptible to an outlier interpretation.

Second, the phrase “exceptionally strong capacity to meet its short-term financial obligations” does not seem to create a floor. Rather, it appears to impose a new, additional standard that may be more stringent than “minimal credit risk.” Currently, Rule 2a-7 permits investment in first and second tier securities, including those with “sub-categories or gradations indicating relative standing” such as “+” and “-.” The words “exceptionally strong” imply that very few issuers will meet this standard. The word “exceptionally” may imply that only top rated securities (or perhaps only top rated securities with the “+” designation) meet the standard.

We share the Commission’s view that removing the ratings quality floor from the Rule should not promote a decline in quality of portfolio holdings. We believe that other regulatory changes ameliorate this concern. For example, the Commission is adopting requirements for increased disclosure of portfolio holdings and market-based net asset value, and the Commission staff has new ways to monitor portfolio risks. The quality of holdings will be more transparent, reducing the need for an additional, new quality standard in the Rule.

⁵ See Letter to Registrants from Kathryn McGrath, Director, Division of Investment Management, SEC (May 8, 1990) and Letter to Matthew Fink, President, Investment Company Institute from Kathryn McGrath, Director, Division of Investment Management, SEC (Dec. 6, 1989).

⁶ See the Investment Company Institute Report of the Money Market Working Group dated March 17, 2009 available at http://www.ici.org/pdf/ppr_09_mmwg.pdf

2. The Commission should eliminate its cross-reference in the proposed Rule to commentary in the Release on the definition of “Eligible security” which conflicts with Section 939A of the Dodd-Frank Act.

The Release includes commentary which suggests that the SEC expects the ratings requirements of Rule 2a-7 to remain in effect, even though the references to ratings have been removed from the Rule.⁷ Further, some of the commentary apparently is intended to be imported into the Rule itself by the following sentence in the proposed definition of “Eligible security:”

⁷ For example, see the following commentary in the Release:

The re-proposed standard, however, is designed to preserve the current degree of risk limitation in rule 2a-7 without reference to credit ratings by requiring a fund’s board (or its delegate) to determine that the issuer of a portfolio security has an exceptionally strong capacity to meet its short-term obligations, a finding that some boards or fund advisers may determine can be met by second tier rated securities (but only of the highest quality). (Release at footnote 44; emphasis added.)

We do not believe that securities that are rated in the third-highest category for short-term ratings (or comparable unrated securities), whose issuers need only have an acceptable or adequate ability to repay short-term obligations under rating agency standards, would satisfy the re-proposed “exceptionally strong capacity” standard. 45 We therefore believe, as a practical matter, that the re-proposed standard would generally preclude funds from determining that securities rated “third tier” (or comparable unrated securities) would be eligible securities under rule 2a-7. (Release at footnote 45; footnote omitted; emphasis added.)

We believe that the re-proposed standard would preclude funds from investing in securities rated third tier (or comparable unrated securities). (Release at footnote 47.)

This standard [for securities with a conditional demand feature] is similar to those articulated by credit ratings agencies for long-term securities assigned the second-highest rating. An issuer that the board determines has a very low risk of default, and a capacity for payment of its financial commitments that is not significantly vulnerable to reasonably foreseeable events would satisfy the proposed standard. We do not believe that securities that are rated in the third-highest category for long-term ratings (or comparable unrated securities), which have expectations of low credit risk or whose obligors have only a strong capacity to meet their financial commitments, would satisfy the proposed standard for underlying securities. (Release around footnote 83; footnotes omitted; emphasis added.)

With regard to the requirement being removed that a security with a conditional demand feature be rated at least second tier, the Commission says, “we recognize the risks of a money market fund investing in securities whose eligibility as portfolio securities depends on a demand feature that would terminate if downgraded by a single rating category, and we believe it would be prudent for a money market fund to avoid investing in these securities.” (Release, text above footnote 89.)

Regarding the removal of provisions requiring monitoring for downgrades and the Board’s related oversight authority, the SEC says, “We also note that a fund adviser’s obligation to monitor risks to which the fund is exposed would, as a practical matter, require the adviser to monitor for downgrades by relevant credit rating agencies because such a downgrade would likely affect the security’s market value. Nevertheless, we acknowledge that one consequence of our proposal would be that a fund adviser could decide to keep a portfolio security that has been downgraded from second tier status without involving the fund’s board in that decision. As part of its oversight of the adviser’s investment decisions, however, we would expect that a fund board

NOTE to paragraph (a)(11)(i): For a discussion of the phrase “exceptionally strong capacity to meet its short-term financial obligations,” see Investment Company Act Release No. 31184, (July 23, 2014).

We recognize that commentary to explain the meaning of a rule is typical and can be useful. However, this commentary is inconsistent with the intent underlying Section 939A of the Dodd-Frank Act. Cross referencing the commentary in the Rule serves only to confuse in this case. We recommend that the Commission delete the cross-reference to the commentary which conflicts with the requirement of the Dodd-Frank Act to remove ratings from Rule 2a-7.⁸

In addition, we believe that commentary stating that the SEC “expects” or “believes” that the ratings criteria and related requirements (such as board oversight) will remain in effect as industry standards may inappropriately encourage some practitioners to feel compelled to manage funds as though the provisions are still in effect. The seemingly inconsistent standards in the Rule and commentary will create uncertainty around the SEC staff’s inspection and enforcement approach. This may create an uneven playing field of differing interpretations of the requirements. The requirements (or elimination of requirements) of the Rule should be clear, so that practitioners can have a consistent understanding across the industry.

To help address this concern, the SEC should clarify that the SEC and its staff will not impose a presumption, during inspections or otherwise, that a security that does not meet the deleted rating standards in the Rule is not eligible under the Rule.

3. The Commission should clarify the proposed requirement that the adviser provide *ongoing* review of whether each security (other than a government security) continues to present minimal credit risks.

The proposals require written procedures that mandate ongoing review by the adviser of whether each security (other than a government security) continues to present minimal credit risks. We ask that the Commission clarify that “ongoing” does not necessarily mean constant or at all

generally should establish procedures for the adviser to notify the board in such circumstances.” (Release text around footnote 108; footnotes omitted; emphasis added.)

As noted above, we do not believe fund managers are likely to invest in third tier securities (or comparable unrated securities) because those securities would not satisfy the re-proposed standard for eligible securities that the security’s issuer have an exceptionally strong capacity to meet its short-term financial obligations. *See supra* note 45 and accompanying and following text. (Release at footnote 203; footnote omitted; emphasis added.)

⁸ For example, Rule 5b-3 includes a similar note to that proposed in this amendment to Rule 2a-7, specifically:

NOTE to paragraph (c)(1)(iv)(C)(I): For a discussion of the phrase “exceptionally strong capacity to meet its financial obligations” see Investment Company Act Release No. 30847, (December 27, 2013).

However, in that case, the release to which the note refers does not include commentary that conflicts with the intent of the Dodd-Frank Act, such as the commentary listed in footnote 7 herein.

times. Rather, an adviser should be permitted to apply a reasonable, common sense approach to the frequency of its minimal credit risk analysis, based on its judgment of current market, economic, business and other conditions. The frequency of review of minimal credit risks may differ from security to security and from time to time.

4. The Commission should reiterate in the adopting release that its commentary on minimal credit risk analysis provides a permissive, not mandatory, list of factors, and is not intended as an exhaustive list of factors required in a minimal credit risk determination.

In the Release, the Commission provides a non-exclusive, permissive list of various factors that could be included in a minimal credit risk analysis, to the extent applicable. We suggest that the Commission reiterate in the adopting release that this list is permissive and not exhaustive and is only relevant to the extent an adviser deems applicable. Without such a caveat, there is danger that such a list, while it could be helpful, will be viewed (in the industry or in examinations) as suggesting a rote “check the box” approach, so that some advisers might be faulted for not considering the named factors, or, on the other hand, might be considered compliant merely by listing and checking the named factors.

5. The Commission should eliminate the requirement to report on Form N-MFP ratings assigned to each security.

The SEC proposes that each money market fund report on Form N-MFP:

each rating assigned by any NRSRO to whose services the fund or its adviser subscribes (together with the name of the assigning NRSRO), and any other NRSRO rating that the fund’s board of directors considered in determining that the security presents minimal credit risks (together with the name of the assigning NRSRO).

Currently the Form requires that a fund report ratings by Designated NRSROs. We recommend that the SEC eliminate the requirement to report subscribed ratings on Form N-MFP

because the requirement conflicts with Section 939A of the Dodd-Frank Act.

Section 939A of the Dodd-Frank Act requires that each covered agency review any regulation that requires the use of an assessment of credit-worthiness and any references to or requirements in such regulations regarding ratings. The agency must “modify any such regulations identified by the review . . . or any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations. [emphasis added.]”⁹ Accordingly,

⁹ Pub. L. No. 111-203, section 939A(b).

the reference to ratings included in the requirement to report ratings on Form N-MFP is inconsistent with Section 939A.¹⁰

Further, we note that the proposal would require disclosure even of those ratings that are not used as part of the credit review. The disclosed ratings would include those by each rating agency to whose services the fund or its adviser subscribes. Ratings by each rating agency to whose services the fund or its adviser subscribes are not necessarily meaningful, because the adviser or fund may subscribe to a rating agency for various reasons unrelated to relying on that rating agency to evaluate the creditworthiness of any particular security. For example, the subscription may be intended to help the adviser keep abreast of market developments generally, to review ratings for only specific securities or types of securities or to provide market color for a security. Accordingly, at a minimum, the Commission should not require disclosure of subscribed ratings that are not used as part of the credit review.

Further, ratings information should not be required to assist the SEC and its staff for research and monitoring purposes. The Commission and its staff can access that information independently if it is needed. Moreover, including ratings in Form N-MFP may mislead investors into believing that ratings should be given more weight than they are due.

6. The Commission should retain in Rule 2a-7 the exception from issuer diversification testing for securities with a guarantee from a non-controlled person of the issuer.

The Commission proposes to tighten the diversification requirements of Rule 2a-7. Rule 2a-7 currently includes two separate diversification tests, one that applies to issuers of securities in a fund and the other that applies to providers of credit support on securities in the fund (specifically, demand features and guarantees). Currently under Rule 2a-7, if a security has a guarantee issued by a non-controlled person of the issuer of the security, an adviser may make a minimal credit risk determination based on the credit quality of the guarantor. In such instances, the fund is looking to the guarantor for payment of principal and interest on the security. Accordingly, the issuer of the security is not subject to the issuer diversification test of the Rule. Only the credit support diversification test applies to that security. The SEC is concerned that the exception permits a fund to have a portfolio highly concentrated in one or a small number of issuers and to be subject to substantial risk if one of the issuers in which it invests is under stress or defaults. The SEC proposes to eliminate this exception to diversification testing. We urge the Commission to retain the exception.

The provider of a guarantee assumes the credit risks presented by a particular issuer by agreeing to provide principal and interest payments in the event the issuer of the underlying security is unable to do so. If a security subject to a guarantee were in default or otherwise became distressed, a money market fund ultimately would rely on the guarantee for payment of

¹⁰ Some of our members have a different view.

principal and interest when due.¹¹ Securities subject to a guarantee typically trade on the basis of the credit quality of the provider of that guarantee. Thus, exposure to the underlying security issuer is not really relevant to a money fund's ability to maintain a stable net asset value in these cases. In light of this reliance on the guarantor, it is not necessary to require a fund to satisfy the Rule's issuer diversification standard with respect to the issuer of the underlying security.

Eliminating the exclusion from issuer diversification testing for a security with a guarantee from a non-controlled person of the issuer would render a guarantee a less attractive feature on a security for both issuers and portfolio managers, because a money market fund investing in a guaranteed security would need to limit its exposure to the issuer without regard to the guarantee. Certain issuers may encounter decreased demand (and increased financing costs) as money market funds must trim their holdings. This disadvantage brings no clear benefit.

Note that this exclusion from issuer diversification testing only applies to securities whose guarantee is provided by a non-controlled persons of the issuer.¹² If the guarantee were provided by a control person of the issuer, the fund still would be required to apply the issuer diversification test to the security. Further, we would note that the Commission already has eliminated the 25% basket for credit support diversification for taxable money market funds, and reduced the basket to 15% for municipal money market funds. The changes to these baskets should alleviate the concentration concerns for guarantees from non-controlled guarantors.

Conclusion

SIFMA respectfully urges the Commission to consider carefully the foregoing comments to ensure clarity when eliminating references to ratings in Rule 2a-7 and to ensure that the changes to Form N-MFP require reporting only of pertinent information. We also urge the Commission to retain the exception to issuer diversification testing for securities with a guarantee by a non-controlled person of the issuer, to avoid a portfolio management constraint that will provide no clear benefit.

¹¹ Under Rule 2a-7, a money market fund may make a finding that it is not relying on the guarantor under the Rule, in which case the exception from diversification testing is unavailable.

¹² A control relationship includes control, controlled by or under common control with the issuer.

Mr. Kevin M. O'Neill

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If you have any questions or require additional information, please do not hesitate to contact Tim Cameron of AMG at 212-313-1389, Matt Nevins of AMG at 212-313-1176, John Maurello of PCG at 212-313-1241 or Joan Swirsky of Stradley at 215-564-8015. Thank you for your attention to these comments.

Sincerely,



Timothy W. Cameron
Managing Director
SIFMA Asset Management Group - Head



John Maurello
Managing Director
SIFMA Private Client Group



Matthew J. Nevins
Managing Director and Associate General Counsel
SIFMA Asset Management Group

cc: The Honorable Mary Jo White
The Honorable Daniel M. Gallagher
The Honorable Kara M. Stein
The Honorable Luis A. Aguilar
The Honorable Michael S. Piwowar
Norm Champ, Director, Division of Investment Management