NEW YORK
CITY BAR

COMMITTEE ON INVESTMENT MANAGEMENT REGULATION

KENNETH J. BERMAN
CHAIR
555 13TH STREET N.W., SUITE 1100E
WASHINGTON, D.C. 20004
Phone: (202) 383-8050
Fax: (202) 383-8118
kjberman@debevoise.com

JOHN G. JEROW
SECRETARY
919 THIRD AVENUE
NEW YORK, NY 10022
Phone: (212) 756-2763
Fax: (212) 593-5955
john.jerow@srz.com

April 29, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number S7-07-11

Dear Ms. Murphy,

The Committee on Investment Management Regulation of the New York City Bar (the "Committee") is composed of lawyers with diverse perspectives on investment management issues, including members of law firms and counsel to financial services firms, investment company complexes and investment advisers. A list of our current members is attached as Annex A.

This letter responds to the request for comment of the Securities and Exchange Commission (the "Commission") in Release IC-29592 (March 3, 2011) (the "Release"), which proposes, among other things, removing references to credit ratings in Rules 2a-7 and 5b-3 under the Investment Company Act of 1940 (the "Investment Company Act") and replacing them with alternative standards of creditworthiness that are designed to achieve the same purposes as the ratings requirements contained in these Rules. The proposed amendments are designed to give effect to Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act"), which requires the Commission to review its regulations for any references to, or requirements regarding, credit ratings that require the use of an assessment of the creditworthiness of a security or money market instrument, remove such references or

requirements and substitute other standards of creditworthiness that the Commission determines to be appropriate.[1]

The Committee appreciates the opportunity to comment on the Commission's proposals. The focus of our comments is on the responsibilities that Rule 2a-7 places on money market fund boards of directors or trustees. The Commission should not adopt these proposals without further amending Rule 2a-7 to address the role of the money market fund board in a manner far more consistent with the way in which fund directors undertake their oversight role consistent with their fiduciary duties under applicable law. A money market fund board should not play the role of a rating agency, having to determine whether a security is a First Tier or Second Tier Security. The Commission should take a similar approach with respect to the proposed amendments to Rule 5b-3, which would dramatically expand the role of a fund board under that Rule.

I. The Appropriate Role of the Fund Board

When money market funds were initially introduced, they posed novel issues that led the Commission to conclude that a "special system of safeguards should be put in place" to protect the funds. Close board oversight was designed to be part of that system of safeguards.[2]

Money market funds have matured, and their initial uniqueness that may have warranted the role of the board in their management has long since passed. The approach of requiring fund boards to make highly technical and specific determinations under Rule 2a-7 should be abandoned. It is simply inconsistent with appropriate fund governance practices to continue to premise the Rule on the assumption that money market fund boards exercise independent judgment over technical day-to-day matters, many of which must be dealt with on very short notice. Such an approach may subject fund directors to significant and unwarranted liabilities given the logistical realities surrounding board meetings.[3]

We believe that the Rule should specify objective criteria to which money market funds are subject without reference to specific board determinations. Other than the responsibility to determine that it is in the best interests of the fund and its shareholders to maintain a stable net asset value and to approve written policies and procedures reasonably designed to comply with the requirements of the Rule, substantially all of the determinations currently required or now proposed are within the expertise of the funds' advisers or could be subject to objective criteria set out in the Rule.

---

[1] The Commission also proposes (i) to remove required disclosures of credit ratings in Forms N-MFP, N-1A, N-2 and N-3 and (ii) a new rule under the Investment Company Act to establish a creditworthiness standard to replace the credit rating reference in Section 6(a)(5) of the Investment Company Act, which was eliminated by the Dodd-Frank Act. We are not commenting on those proposals.

[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 Rel. No. 13380 (July 11, 1983) (adopting Rule 2a-7).

[3] We believe that the premise underlying the proposed amendment to Rule 5b-3 is similarly flawed.

As the Committee has previously noted, the determinations that money market fund boards are required to make under the Rule are highly technical and inconsistent with the general oversight responsibilities of fund boards.[4] Notwithstanding the delegation provisions of paragraph (e) of Rule 2a-7, the Rule continues to involve fund directors in a level of fund management that is inconsistent with their oversight role. A fund board should not be expected to substitute its judgment for that of a rating agency, credit analyst or other investment professional. Moreover, making a responsibility delegable does not cure the problem of making fund boards inappropriately responsible for such determinations, since boards that choose to delegate (as virtually all do under Rule 2a-7 and all will under Rule 5b-3) would retain ultimate responsibility for the determinations made by their delegates.

The Commission should tread cautiously when assigning additional specific duties to investment company boards. The Committee suggests that a money market fund board's role under Rule 2a-7, or any Investment Company Act rule, be based on the guiding principle that determinations that draw only upon professional investment expertise peculiarly within the possession of the fund's adviser (*e.g.*, determining the credit quality or liquidity of a security) or that, if assigned to the directors, would require a degree and frequency of involvement that extends beyond the board's proper oversight role, should be the responsibility of the adviser. The Committee believes that the ability of fund directors to exercise their general oversight responsibilities under state law and the Investment Company Act is hindered to the extent they must devote significant attention to these types of matters to satisfy requirements under Commission rules, and this approach is not in the best interests of funds or their shareholders.

The expansion of responsibilities that would be imposed on fund boards by the proposed amendments is not warranted and is totally inconsistent with the public statements of Commissioners and Commission staff on the role of the fund board.[5] We note, as we have in the past, that our views concerning appropriate responsibilities for mutual fund boards are consistent with those of the Division of Investment Management, as expressed in its 1992 study of mutual fund regulation, which includes the following statement:

> We believe that independent directors are unnecessarily burdened, however, when required to make determinations that call for a high level of involvement in day-to-day activities. Rules that impose specific duties and responsibilities on the independent directors should not require them to "micro-manage" operational matters. To the extent possible, operational matters that do not present a conflict between the interests of advisers and the investment

4 *See, e.g.*, the Committee's comment letter, dated September 8, 2009, in response to the Commission's 2009 release proposing amendments to Rule 2a-7 at File No. S7-11-09.

5 *See, e.g*, Custody of Investment Company Assets with Futures Commission Merchants and Commodity Clearing Organizations, Release No. IC-22389 (Dec. 11, 1996) (objective standards in a rule makes provisions concerning board oversight unnecessary).

> companies they advise should be handled primarily or exclusively by the investment adviser.[6]

II. The Proposed Amendments to Rule 2a-7

Under Rule 2a-7, an Eligible Security is defined as, among other things:

- A Rated Security with a remaining maturity of 397 calendar days or less that has received a rating from the Requisite NRSROs in one of the two highest short-term rating categories (within which there may be subcategories or gradations indicating relative standing); or

- An Unrated Security that is of comparable quality to a security meeting the requirements for an Eligible Security that is a Rated Security, as determined by the money market fund's board of directors.

A "First Tier Security" is defined as including, among other things:

- An Eligible Security that is a Rated Security that has received a short-term rating from the Requisite NRSROs in the highest short-term rating category for debt obligations (within which there may be subcategories or gradations indicating relative standing); or

- An Unrated Security that is of comparable quality to a security meeting the requirements for a First Tier Security that is a Rated Security, as determined by the fund's board of directors.

Thus, a fund board need not make any determination whether a security is Eligible or First Tier unless the security is not rated.

By contrast, under the proposed amendment, an Eligible Security is a security "with a remaining maturity of 397 calendar days or less that the fund's board of directors determines presents minimal credit risks (which determination must be based on factors pertaining to credit quality and the issuer's ability to meet its short-term financial obligations)." A First Tier Security would be an Eligible Security "the issuer of which the fund's board of directors has determined has the highest capacity to meet its short-term financial obligations." One of the key determinations that must be made under the Rule – that a rated security is a First Tier Security – would be, for the first time, under the Proposal, the responsibility of the fund board.[7] As discussed above, this inappropriately places a board in the role of a rating agency.

---

[6] SEC, Protecting Investors: A Half Century of Investment Company Regulation (1992) at 266.

[7] At least 97 percent of a fund's assets must consist of First Tier Securities. In addition, paragraph (c)(3)(ii) of Rule 2a-7 provides that a money market fund may not acquire a "Second Tier Security" with a remaining maturity of greater than 45 calendar days. Thus, a fund board's determination that a security is First Tier will be key to the fund's compliance with the Rule's credit quality and maturity determinations.

The approach taken with respect to Conditional Demand Features further demonstrates the inappropriate role that has been assigned to fund boards under Rule 2a-7. Under the proposed amendments, a board (or its delegate) would have to determine that the underlying security is of high quality and subject to very low credit risk. "An issuer that is determined to have a very strong capacity to meet its financial commitments, 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 definition."

We respectively submit that such fine grained determinations are more appropriately made by an investment adviser rather than a fund board. In the Committee's view, these new determinations unreasonably and inappropriately burden directors with the responsibility for determinations that are very difficult for non-investment experts to make, except in reliance on others, and would require a degree and frequency of involvement in day-to-day fund operations that extends beyond the general oversight responsibilities of fund boards.

The Commission has suggested that the standards imposed by the rating agencies may not necessarily satisfy the standards of the Rule. While the standards proposed by the Commission appear to be objective (*e.g.*, for First Tier Securities, "has the highest capacity to meet its short-term financial obligations") the Commission notes that these standards "would eliminate the objective standard provided by credit ratings in the definitions of eligible security and first tier security and instead require a subjective determination of both eligible securities and first tier securities."

This approach appears to be inconsistent with the Commission's efforts to assure that the money market fund investment be limited to high-quality short-term instruments; if the Commission must drop all references to rating agencies, it should develop a standard that can be consistently applied by all money market funds. The proposed approach also seems to be inconsistent with the Commission's reassurance that a board "would still be able to consider quality determinations prepared by outside sources, including NRSRO ratings, that fund advisers conclude are credible and reliable, in making credit risk determinations."[8] Being able to rely on a NRSRO rating would at least provide some assurance that the new standard would be consistent with the standard that boards and advisers are familiar with.

The Committee respectfully suggests that these determinations not be assigned to the board; rather they should be specified as objective requirements that a money market fund must comply with in order to rely on Rule 2a-7.

III. Rule 5b-3

Rule 5b-3 allows funds to treat the acquisition of a repurchase agreement as an acquisition of securities collateralizing the repurchase agreement for purposes of Sections 5(b)(1) and 12(d)(3)

---

[8] It would be helpful to fund boards and their advisers if the Commission could confirm either in the Rule or in the adopting release that a board could rely exclusively on ratings in determining whether a security is an Eligible and First Tier Security. Providing such a safe harbor would not be inconsistent with Section 939A. This safe harbor would not replace the Rule's requirement that securities must be determined to present minimal credit risks (a determination that we believe should be made by the fund's investment adviser and not the board).

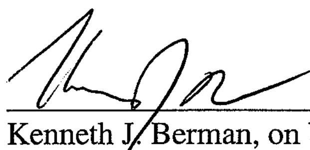
of the Investment Company Act if the obligation of the seller to repurchase the securities from the fund is "collateralized fully." A repurchase agreement is collateralized fully if, among other things, the collateral for the repurchase agreement consists entirely of (i) cash items, (ii) government securities, (iii) securities that at the time the repurchase agreement is entered into are rated in the highest rating category by the "requisite NRSROs" or (iv) unrated securities that are of a comparable quality to securities that are rated in the highest rating category by the requisite NRSROs, as determined by the fund's board of directors or its delegate.

The Commission proposes to eliminate the requirement that collateral other than cash or government securities be rated in the highest category by the requisite NRSROs or be of comparable quality and replace it with a requirement that collateral other than cash or government securities consist of securities that the fund's board of directors (or its delegate) determines at the time the repurchase agreement is entered into are: (i) issued by an issuer that has the highest capacity to meet its financial obligations; and (ii) sufficiently liquid that they can be sold at approximately their carrying value in the ordinary course of business within seven calendar days.

The proposed amendments to Rule 5b-3 has all of the flaws of the proposed amendments to Rule 2a-7: fund boards would be assigned responsibility for making determinations that are not within their expertise. Rule 5b-3 goes a step further than the proposed amendment to Rule 2a-7 and would have the board not only making credit quality determinations but also liquidity determinations. The Commission proposes to assign this responsibility to the board even though it concedes that "fund advisers have experience with or knowledge of the evaluation of securities and would be qualified to make the credit and liquidity determinations proposed under the rule." No rationale is provided for assigning this responsibility to the fund board; there does not appear to be any reason why a fund's investment adviser could not make these assessments. The Commission should modify the proposal by deleting the board determination requirements from Rule 5b-3.

* * *

The Committee appreciates the opportunity to comment on the Proposals. If we can be of any further assistance in this regard, please do not hesitate to contact the undersigned by telephone at (202) 383-8050 or by e-mail at kjberman@debevoise.com.



Kenneth J. Berman, on behalf of
The Committee on Investment Management
Regulation of the New York City Bar

Annex A

Members of the Committee on Investment Management Regulation

Barry P. Barbash
John E. Baumgardner
James N. Benedict
Kenneth J. Berman, Chair
Peter Bonanno
Frank P. Bruno
Paul Cellupica
Bryan Chegwidden
Sara E. Cogan
Ronald M. Feiman
Robert I. Frenkel
Paul Goucher

Gary L. Granik
William V. Healey
Michael K. Hoffman
Steven R. Howard
John G. Jerow, Secretary
Clifford Kirsch
Patricia Louie
Leonard B. Mackey
Lori A. Martin
Ajay Mehra
Kathleen H. Moriarty
Marguerite E.H. Morrison
Carin F. Muhlbaum

Frank J. Nasta
Patrick M. Patalino
Brynn D. Peltz
Francis C. Poli
Daniel A. Pollack
Kathryn L. Quirk
Jon S. Rand
Gregory S. Rowland
Lawrence B. Stoller
Stuart Strauss
Patrick D. Sweeney
Emilie D. Wrapp

Drafting Committee

Barry P. Barbash
John E. Baumgardner
Kenneth J. Berman
Frank P. Bruno
Clifford Kirsch
Frank J. Nasta
Gregory S. Rowland