NEW YORK CITY BAR

COMMITTEE ON INVESTMENT MANAGEMENT REGULATION

KATHRYN L. QUIRK
CHAIR
725 HARVEST HILL DRIVE
CHALFONT, PA 18914
PHONE: (215) 822-8320
klquirk@comcast.net

DIANNE E. O'DONNELL
SECRETARY
787 SEVENTH AVENUE
FL 40
NEW YORK, NY 10019-6099
PHONE: (212) 728-8558
FAX: (212) 728-9558
do'donnell@willkie.com

October 14, 2014

Mr. Kevin M. O'Neill
Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule (Rel. No. IC-31184) (File No. S7-07-11)

Dear Mr. O'Neill:

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 members is attached as Annex A.

This letter responds to the request for comment of the Securities and Exchange Commission (the "Commission") in Release No. IC-31184 (July 23, 2014) (the "Re-Proposing Release"), in which the Commission has re-proposed amendments to Rule 2a-7 ("Proposed Amendments") that would, among other things, remove references to credit ratings of nationally recognized statistical rating organizations ("NRSROs")[1] in Rule 2a-7 (the "Rule") under the Investment

[1] The term "NRSRO" is defined in the Rule by reference to Section 3(a)(62) of the Securities Exchange Act of 1934.

Company Act of 1940 (the "Investment Company Act").[2] As stated in the Re-Proposing Release, 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 (1) review its regulations for any reference to, or requirements regarding, credit ratings that require the use of an assessment of the creditworthiness of a security or money market instrument, (2) remove such references or requirements and (3) substitute other standards of creditworthiness that the Commission determines to be appropriate.[3]

The Committee again appreciates the opportunity to comment on the Commission's Proposed Amendments. In this letter we again stress, as we did in the Committee's 2011 Comment Letter, the importance that any amendments to Rule 2a-7 that the Commission adopts clearly set forth in the Rule itself, or in commentary in the Adopting Release for whatever final amendments the Commission may adopt, explicit recognition of the legal standards that the Commission will apply to its review of the actions the board of directors or trustees ("Board") of a money market fund that the Board might take[4] to promote the fund's compliance with the Rule. We urge that such explicit standards recognize that such Board action shall be measured by the reasonableness of the Board's exercise of its business judgment.

Because of the lack of clarity in the definition of, and absence of a legally objective point of reference with respect to, the proposed "exceptionally strong capacity" standard that a money market portfolio security would be required to meet to be an "eligible security" under the Proposed Amendments, this letter also comments on what we believe would be the possible legal implications of such standard. We also discuss our concerns whether the meaning of such standard will be clear and comprehensible to investors in disclosure documents relating to money market funds.

Finally, we express our hope for further clarity through the inclusion of an objective legal standard in the Proposed Amendments to Rule 2a-7 with respect to the assignment of responsibilities for "ongoing monitoring" or "ongoing review" of a money market fund's portfolio securities to determine that such securities continue to present "minimal credit risk," including the proposed requirements with respect to the maintenance of written records of such determinations.

1. Applicability of a Reasonableness Standard to the Actions and Determinations by the Boards of Money Market Funds under Rule 2a-7

The Proposed Amendments set forth a number of obligations for fund Boards with respect to oversight of a money market fund's compliance with Rule 2a-7's conditions. As stated in the

---

[2] The Re-Proposing Release was issued by the Commission in response to comments it received on its prior rule proposal on this topic, Release No. IC-29592 (March 3, 2011) (the "Original Proposing Release"), which proposed removal of references to credit ratings in Rules 2a-7 and 5b-3 under the Investment Company Act and replacing them with alternative standards of creditworthiness that were designed to achieve the same purposes as the ratings requirements contained in those rules. The Committee had submitted a comment letter, dated April 29, 2011, to the Commission, on the Original Proposing Release (the "Committee's 2011 Comment Letter"). In the interim period between the issuance of the Original Proposing Release and the issuance of the Re-Proposing Release, the Commission adopted other significant amendments to Rule 2a-7 (*Money Market Fund Reform; Amendments to Form PF.* Release No. IC-31166 (July 23, 2014) (the "July 2014 Money Market Fund Reform Adopting Release")).

[3] We note that the Re-Proposing Release also includes proposed amendments to Form N-MFP. This letter does not comment on those proposed amendments to the Form.

[4] For example, if the Commission determines to include that language in the Rule itself, it could be included in proposed Rule 2a-7(a)(11)(i).

Committee's 2011 Comment Letter, the Committee remains concerned about the approach taken in the Proposed Amendments to the assignment of responsibilities to a money market fund's Board, particularly (in the absence of objective legal standards for measurement of a security's quality) with respect to the board's responsibility for, and involvement in, determinations that a portfolio security is of high quality. We therefore urge that the Re-Proposing Release include a statement by the Commission recognizing that the Commission will continue to assess a Board's exercise of such responsibilities under the Rule in light of the Board's good faith application of its reasonable business judgment.

That recognition, and explicit statement, would be consonant with prior approaches taken by the Commission with respect to Board responsibilities arising under the Rule. In its adopting release for Rule 2a-7 in 1983,[5] the Commission addressed the nature and extent of Board responsibilities with respect to compliance with the various requirements of the Rule. In particular, the Commission addressed the concerns of some commenters on the proposed version of the Rule with respect to the extent of a Board's ability to delegate responsibility for day-to-day portfolio management oversight that some commenters thought was imperiled by the then-proposed Rule:

> In meeting the rule's requirement that the fund invest only in those securities which the board determines to meet certain quality standards, the board may delegate to the investment adviser the responsibility for investigating and judging the creditworthiness of particular instruments. However, like the procedures discussed above, the board must exercise sufficient oversight if it wishes to delegate this function to the investment adviser. Again, sufficient oversight would involve the board setting guidelines, its approval of the adviser's methods in advance and routine surveillance of the adviser's performance.[6]

Furthermore, in adopting Rule 2a-7 in 1983, the Commission commented on the nature and extent of Board fulfillment of the responsibilities set forth in the Rule in response to concerns by commenters that no presumptions of failure by a fund's Board to fulfill its responsibilities should arise from a fund's failure to maintain a stable net asset value. In pertinent part, the Commission stated that:

> [T]he Commission does not expect the board of directors to be insurers of the activities of the investment adviser or the fund. ***The Commission has evaluated in the past, and would similarly evaluate in the future, the actions of the board of directors based upon a reasonable business standard*** (emphasis added) . . . The mere adoption of those specific procedures required by the rule and exemptive orders will not, *per se*, fulfill the board's responsibilities. On the other hand, if a board adopts procedures which are reasonably designed to assure stability and the board acts in a reasonable fashion to assure that those procedures are followed, the Commission would not hold the board responsible for any failure to maintain a stable net asset value per share.[7]

In light of the statements made by the Commission in the 1983 Adopting Release with respect to the application of a reasonable business standard to a money market fund Board's exercise of its responsibilities under the Rule, it was therefore of concern to the Committee that the

---

[5] Release No. IC-13380, "Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds)," Jul. 11, 1983 (the "1983 Adopting Release").
[6] 1983 Adopting Release, 48 Fed. Reg. 138 at p. 32561.
[7] 1983 Adopting Release, 48 Fed. Reg. 138, footnote 42, at p. 32562.

Commission chose not to restate that position in adopting the amendments to the Rule announced in the July 2014 Money Market Fund Reform Adopting Release, or in the Re-Proposing Release. In response to comment letters urging the Commission to acknowledge the applicability of a business judgment standard to deliberations of a money market fund Board with respect to consideration of the imposition of fees or gates under the Rule, at page 91 in the July 2014 Money Market Fund Reform Adopting Release, the Commission stated: "we do not believe it would be appropriate for us to address the application of the business judgment rule because the business judgment rule is a construct of state law and not the federal securities laws." The Committee appreciates the Commission's acknowledgment of the applicability of a business judgment standard under applicable state law to the conduct of fund Boards and believes that position is consonant with the Commission's earlier statements with respect to the responsibilities of money market fund Boards. The Committee therefore believes it would be helpful to state in the final release for any Proposed Amendments to the Rule that may be adopted that the Commission's 1983 position on evaluating Board conduct has not changed.

2. Proposed Amendments to the Definition of "Eligible Security" in Rule 2a-7(a)(12): the Proposed "Exceptionally Strong Capacity" Standard.

The Commission asks in the Re-Proposing Release whether "the re-proposed 'exceptionally strong capacity' standard [is] an appropriate substitute for credit ratings in rule 2a-7," and whether "the re-proposed consolidated standard, which requires a minimum credit risk determination and includes a finding that the issuer has an 'exceptionally strong capacity' to meet its short-term obligations, provide[s] sufficient clarity for money market fund boards and advisers making credit quality determinations." For the reasons set forth below, we believe the answers to both questions are "no" because the proposed new standard lacks clarity and objective criteria having readily understandable and ascertainable points of reference that are necessary in a legal standard.

a. Lack of Clarity in the Proposed Standard of "Exceptionally Strong Capacity." Rule 2a-7 contains a number of "risk-limiting" conditions designed to minimize the amount of risk a money market fund may assume. Among those conditions, Rule 2a-7 limits a money market fund's portfolio investments to "eligible securities," which Rule 2a-7(a)(12) defines as securities that have received credit ratings from the "requisite NRSROs" (as defined in amended Rule 2a-7(a)(24)) in one of the two highest short-term rating categories or comparable unrated securities. The Proposed Amendments to the Rule would define an "eligible security" as one with a remaining maturity of 397 calendar days or less that the fund's Board (or its delegate) determines presents minimal credit risks. That determination includes a finding that the security's issuer has an "exceptionally strong capacity to meet its short-term financial obligations." The Proposed Amendments eliminate the distinction between First-Tier and Second-Tier securities, replacing them with the single "exceptionally strong capacity" standard. However, the Proposed Amendments to the Rule do not set forth any means by which a security's satisfaction of the "exceptionally strong capacity" standard should be determined.

The use of NRSRO credit quality standards and the alignment of the definitions of First-Tier and Second-Tier securities with specific NRSRO ratings standards under the current Rule provide investors with a widely familiar, readily-understandable reference to standards of quality and also assure that money market funds, their investment advisers and Boards will all be expected to apply the same credit-quality standards in the selection and retention of portfolio securities. The required removal of those NRSRO standards poses a number of challenges to the Commission in providing alternate measures of credit quality that will promote investor understanding as to the

risks posed by portfolio securities held by their money market funds, while assuring that all industry participants apply readily understandable objective standards, rather than a relative standard that is vague and potentially confusing, for the selection of portfolio securities.

While it would undoubtedly be impracticable to require all investment advisers to money market funds to operate in the manner of, and under the same Commission standards that apply to, NRSROs under the Securities Exchange Act of 1934 with respect to credit quality determinations, the Committee is concerned that the proposed "exceptionally strong capacity" standard will not promote investor understanding of credit quality standards used by money market funds nor have meanings as well understood (by the general public and industry professionals) as the NRSRO quality standards that the "exceptionally strong capacity" standard would replace.

The Commission also asks whether "such a [exceptionally strong capacity] standard [will] impact investors' understanding of credit quality." Again, we believe such standard has no point of reference that would promote investor understanding of the credit quality of money market fund instruments, unlike NRSRO ratings, and will therefore not provide useful information to investors, absent further definitional guidance from the Commission with respect to the credit quality standard that money market funds should include in their disclosure documents for investors. In part, that difficulty arises from applying a single standard, "exceptionally strong capacity," to securities that could fall within two different rating categories currently used by NRSROs.

In the Re-Proposing Release, the Commission discusses the language currently used by NRSROs in describing their criteria for designating top-rated short-term securities (those securities that are currently defined as "First-Tier" securities under the Rule). The Commission states that "[t]he 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,"[8] but the Commission illustrates that statement with a footnote discussion of the language used by the three principal rating agencies, Standard & Poor's, Moody's and Fitch, to describe securities in their respective highest short-term rating categories: none of them use the term "exceptionally strong capacity" to do so.[9] Despite the Commission's commentary suggesting that certain securities that would now be deemed "Second Tier Securities" under the Rule could meet the "exceptionally strong capacity" standard, common understanding of the meaning of the word "exceptionally" appears to undercut that careful analysis by the Commission. The terms "strong" or "superior capacity to meet short-term obligations" would appear to more closely approximate a more "common denominator" description of First and Second Tier securities used by the rating organizations and thus could better reflect the Commission's intention to allow their inclusion in a money market fund's portfolio.

b. There is a Need for More Objective Standards in the Proposed Amendments for Determining Minimal Credit Risk. In the Re-Proposing Release, the Commission notes that "Rule 2a-7 does not set forth any specific factors that a Board (or its delegate) should consider in determining minimal credit risks."[10] However, we believe that the current Rule does contain certain NRSRO ratings criteria that can fairly be said to be "considerations" in determining

---

[8] Re-Proposing Release, p. 14.

[9] S&P's definition refers to an issuer's "strong" capacity to meet its financial obligation on the commitment; Fitch refers to the issuer as having the "strongest intrinsic capacity for timely payments of financial commitments," and Moody's refers to "a superior ability to repay short-term debt obligations. Re-Proposing Release at footnote 38.

[10] Re-Proposing Release at p. 20.

minimal credit risk. In light of the removal of the explicit benchmark standards of NRSRO ratings from the Rule, we believe that the amended Rule itself should contain a statement of at least basic considerations that should guide money market fund investment advisers and Boards in making such determinations. As discussed below, the inclusion of such considerations in the Rule itself, in light of the removal of NRSRO credit rating standards, will promote more uniform compliance practices and procedures and will set benchmarks for the inspection of fund business records by the Staff of the Commission.

The Re-Proposing Release sets forth extensive considerations for investment advisers in interpreting the "exceptionally strong capacity" standard. That discussion includes a statement by the Commission that: "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) [footnote omitted.]" [11] The Re-Proposing Release offers guidance (to which the Rule would make a cross-reference under the Proposed Amendments) as to what the Commission believes would be the basic factors that all money market fund investment advisers should follow in assessing whether a portfolio security has minimum credit risk.

In the absence of specific NRSRO ratings categories in the Rule, the Committee believes that it would be desirable to include those basic standards as part of the Rule itself, to (1) provide a basis to communicate such standards to investors in money market fund prospectuses, (2) promote the adoption of industry-wide credit quality standards that would facilitate compliance by money market funds with the Rule, (3) promote the ability of money market fund Boards to oversee the actions of fund advisers, and (4) promote uniform compliance standards for record-keeping and staff inspection purposes.

The Commission's discussion of considerations for making credit risk determinations in the Re-Proposing Release provides a basis for inclusion in the Rule itself of basic credit quality standards for money market fund portfolio securities.

On pages 23-25 of the Re-Proposing Release, the Commission discusses other factors that would apply to minimal credit risk determinations with respect to specific security types, and notes that the list is not exhaustive. The Committee believes that this discussion of additional factors could also be included in the Rule, for the reasons discussed above, to provide clear standards for money market funds, their advisers and Boards. The Committee notes that such inclusion would be akin to the Commission's provision of clear standards with respect to valuation in Accounting Series Release 118, which forms the core of the valuation policies and procedures of many investment companies today. While the Committee recognizes that any general factors stated in the Rule would not be substitutes for security-specific analysis for determining minimal credit risk (and presumably the Rule would so state), their inclusion in the Rule would provide a clear,

[11] Re-Proposing Release, p. 16. There is no guidance in the Re-Proposing Release as to what standards an adviser should apply to second-tier securities to determine that they are the "highest quality" of (presumably) second-tier securities, as contrasted with first-tier securities or other second-tier securities. The only uses of the term "exceptionally strong capacity" among the current ratings standards are for International Long-Term Issuer Ratings by Fitch, Inc. The phrase "exceptionally strong" by itself is also used to describe a special added feature of certain, but not all, instruments in Fitch Inc.'s highest category of International Short-Term Issuer Ratings, just as the phrase "extremely strong" is used by Standard & Poor's Rating Services to identify a limited subset of the obligations in its highest category of short-term debt.

uniform basic framework for such analysis to which all industry participants would be subject. We believe the description of such standards in money market fund prospectuses would help promote the provision of useful information to investors about the security selection process for money market funds.

3. Monitoring Minimal Credit Risks.

Among the "risk-limiting" conditions of Rule 2a-7(d), Rule 2a-7(d)(2) contains a portfolio quality condition that requires money market funds to limit their investments to certain securities that the fund's Board determines present minimal credit risk. That provision states that the Board's determination must be based on factors pertaining to credit quality in addition to any ratings by NRSROs; additionally, such securities must be, at time of acquisition, "eligible securities" as defined in the Rule. As the Commission notes in the Re-Proposing Release, current Rule 2a-7 does not impose an explicit requirement for "monitoring" (by the fund's investment adviser or the Board) whether a money market fund's portfolio securities continue to present minimal credit risk after their acquisition.[12] However, the Commission further states its belief that "most" fund investment advisers currently engage in ongoing monitoring because of certain business practices that would appear to suggest the prudence of such monitoring; the Commission therefore expresses its belief that imposing a specific requirement for "ongoing monitoring" would not change "current business practices."

However, as discussed below, the Commission does not fully set forth in the Proposed Amendments what those "monitoring" business practices are or should be. In light of the implication in the Re-Proposing Release that not all money market funds and their investment advisers currently follow such "ongoing monitoring," the absence in the Proposed Amendments of any description of what such practices should encompass, at a minimum, causes concern from the perspective of informing registrants, their investment advisers and Boards of the standards to which the Commission will hold them for purposes of record-keeping, inspection, and possible enforcement proceeding purposes.

Rule 2a-7(f)(1)(i) currently contains an implicit "ratings-driven" monitoring requirement with respect to oversight of a fund's portfolio securities. It 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 upon such reassessment to take such action as the Board determines is in the best interests of the fund and its shareholders.[13] In response to the mandate in Section 939A of the Dodd-Frank Act, the Proposed Amendments would eliminate the requirement in current Rule 2a-7(f)(1) that a fund must reassess the credit risks of an issuer of a portfolio security when the security is downgraded by an NRSRO. In the Re-Proposing Release, the Commission states that instead of that ratings downgrade review requirement, under the Proposed Amendments, Rule 2a-7(g)(3) would require that each money market fund's written procedures require the fund's investment adviser to provide "ongoing review" of the credit quality of each portfolio security other than a government security (including any guarantee or demand feature on which the fund relies to determine portfolio quality, maturity, or liquidity) to determine that the security continues to present minimal credit risks.

[12] Re-Proposing Release, at p. 34.

[13] In addition, current Rule 2a-7(g)(3) contains other portfolio monitoring requirements, mandating that the fund's procedures include provisions for ongoing review of the minimal credit risks associated with securities for which maturity is determined by reference to a demand feature. This provision would be removed by the Proposed Amendments.

Proposed subsections (i) and (ii) of Rule 2a-7(g)(3) merely state that such "review" must "(i) [i]nclude an assessment of each security's credit quality, including the issuer's capability to meet its short-term financial obligation," and (ii) "[b]e based on, among other things, financial data of the issuer" of the security or provider of the guarantee or demand feature, or, in the case of a security subject to a conditional demand feature, the issuer whose financial condition must be "monitored" under proposed Rule 2a-7(e)(2)(iii).

Certain of the Commission's questions in the Re-Proposing Release themselves illustrate the consequences of removing explicit, uniformly applicable review and diligence standards from Rule 2a-7 and replacing them with an "ongoing review" requirement with respect to the credit quality of each portfolio security. For example, the Re-Proposing Release asks whether the Rule should include specific, objective events that would require reevaluation of minimal credit risks. A second question asks whether replacing the specific event-driven requirements for monitoring portfolio securities' credit risks in the event of a ratings downgrade with a requirement for ongoing monitoring would result in less or more diligence on the part of money market fund managers. Those questions highlight the legal ambiguity that would result from the requirements of "ongoing review." What standards would the SEC and its staff apply to assessing the adequacy of a fund's procedures and record-keeping practices during inspections of money market funds, their investment advisers and Boards, as well as in pursuing enforcement actions that could result from such inspections? The lack of explicit, uniformly-applied standards creates the possibility of a substantial degree of uncertainty in the fund industry as to the meaning of "ongoing review."

The Re-Proposing Release does contain certain statements that appear to indicate some of the Commission's views as to elements of an ongoing monitoring program for portfolio securities. In the Re-Proposing Release, but not in the text of the Proposed Amendments, the Commission states that such 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. We note that funds could continue to consider external factors, including credit ratings, as part of the ongoing monitoring process (footnotes omitted)."[14] The Commission goes on to state that "[w]e 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 (footnote omitted)," and that the Commission would "expect" that as part of such provisions for reassessment of minimal credit risks, the procedures would include a provision requiring notification of the Board of any such reassessments.[15] If the Commission's statements represent standards to which money market funds, their investment advisers and Boards will be held for purposes of Rule 38a-1 compliance, inspections, books and record requirements and enforcement actions, we suggest that the Commission consider whether it would be preferable to include such standards in the Proposed Amendments to the Rule, to assure uniform industry practices and procedures.

[14] Re-Proposing Release, pp. 33.-34.
[15] Re-Proposing Release, p. 35.

While we understand that to a large degree the compliance policies and procedures of a money market fund must depend on the nature and complexity of the particular fund's investment policies and portfolio security types, the Re-Proposing Release makes it clear that the Commission intends to hold all money market funds, and their investment advisers and Boards, accountable, through the inspection process and possible administrative or other legal process, to maintain policies and procedures to "ensure that funds are better positioned to quickly identify potential risks of credit events that could impact portfolio security prices and ultimately, for [retail and government money market] funds, the ability of the fund to maintain its stable net asset value."[16]

We believe that at a minimum the Rule, rather than a release, should set forth clear standards that the Commission will apply to such activity by a money market fund, its Board and its investment adviser, to promote, to the extent possible, more uniform compliance practices in the money market fund industry, and to enhance the ability of funds, their advisers and Boards to understand what the Commission believes are the basic standards that funds and their advisers should employ to monitor that the fund's portfolio securities present minimal credit risks. That approach would promote adherence to a single legal standard by money market funds with respect to those operational practices.

We note that the Commission's language in the Re-Proposing Release commentary uses "ongoing review" and "ongoing monitoring" somewhat interchangeably. We are concerned that the Re-Proposing Release may raise uncertainty among money market funds, their advisers and Boards as to the standards that the Commission would apply to the required frequency of reassessment whether a portfolio security continues to be an eligible security in that it presents minimal credit risks, and to measure a fund's compliance with the requirement for "ongoing review" or "ongoing monitoring" of portfolio securities for record-keeping purposes. That concern is highlighted by the Commission's statement that an investment adviser would not be expected to maintain written documentation of each activity constituting "ongoing review" under proposed Rule 2a-7(h)(3), in contrast to the requirement to maintain written documentation each time it determines that a security continues to be an eligible security because it presents minimal credit risks. In Footnote 99 of the Re-Proposing Release, the Commission recognizes the uncertainty that would be raised under the Proposed Amendments as to the written documentation required for an adviser's demonstration that it has implemented a process of "ongoing review" of the credit quality of a fund's portfolio securities:

> Because under our re-proposal a fund adviser would be required to conduct an ongoing review of the credit quality of a fund's portfolio securities, rule 2a-7's current recordkeeping requirement could be understood to require the fund to provide for an ongoing documentation of the adviser's ongoing review, which could prove burdensome. Accordingly, our re-proposal would require the fund to maintain and preserve a written record of the determination that a portfolio security presents minimal credit risks at the time the fund acquires the security, or 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. *See* re-proposed rule 2a-7(h)(3).[17]

[16] Re-Proposing Release at p. 36.
[17] Re-Proposing Release, p. 33.

However, in the Committee's view, the language of proposed Rule 2a-7(h)(3) does not make that distinction between "ongoing review" and minimal credit risk determinations clearly. We are also concerned that the Proposed Amendments do not underscore that an investment adviser need not make daily "determinations" of credit quality of portfolio securities in the normal course of events, but rather that the frequency of such determinations should be event-driven – for example, based upon market volatility or the issuance of news with respect to a specific issuer to which the investment adviser has reasonable access.

For example, if an investment adviser's personnel review NRSRO credit ratings for a money market fund's portfolio securities on a daily basis, along with other financial data with respect to an issuer, does that constitute a "determination that a portfolio security is an eligible security" requiring the adviser to retain written (or electronic copies) of such daily ratings review and other data? The language in the Proposed Amendment "or 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" does not address that ambiguity. We suggest that proposed Rule 2a-7(h)(3) would be clearer if the distinction between "ongoing review" and minimal credit risk determinations that are made upon reassessment of such credit risks were more clearly stated, to pin the requirement for recordkeeping on the occurrence of a determination as to credit quality, rather than the act of normal portfolio management practices in reviewing data as to portfolio securities. To accomplish that purpose, we suggest language as follows:

> (3) *Credit risk analysis.* A written record must be maintained and preserved in an easily accessible place for a period of three years from the date that the credit risks of a portfolio security were most recently reviewed for the purposes of a determination that the portfolio security is an eligible security, including (i) the determination made by the fund's investment adviser at the time the fund acquires the security that it presents minimal credit risks, or (ii) upon the occurrence of a credit event affecting the security, the knowledge of which becomes reasonably available to the fund's investment adviser engaged in the monitoring of the credit risks of a fund's portfolio securities, or (iii) a determination made by the fund's investment adviser as a result of a reassessment of a security that has been acquired by a fund that such security does or does not continue to present minimal credit risks; such reassessments shall be made at such times or upon such events the fund's board of directors determines and shall promptly be reported to the fund's board.

We believe that the Commission's goal was to create an objective standard for such record-keeping as well as the assessment of minimal credit risks. To that end, however, the Commission's attempt to distinguish between records demonstrating an adviser's review of the credit quality of proposed portfolio securities at time of acquisition[18] and records documenting the adviser's "ongoing review" of the credit quality of such securities appears to conflict with statements made later in Footnote 109 in the Re-Proposing Release as to the adviser's obligation to demonstrate, during SEC staff inspections and in response to Commission disciplinary actions, its "ongoing review" of each security in the fund's portfolio (which, as noted above, includes a determination that each security continues to satisfy the minimal credit risk requirement of Rule 2a-7):

[18] Neither the Re-Proposing Release nor proposed rule 2a-7(h)(3) provides ~~no~~ any guidance or examples of what is meant by "such later times" or "events" specified by the fund's Board.

> In the context of such an examination, a fund should be able to *support each minimal credit risk determination* it makes in light of financial data or market data it has considered with appropriate documentation to reflect that process and determination. A fund that acquires portfolio securities without having adopted, maintained, or implemented written policies and procedures reasonably designed to assess minimal credit risk, as required under rules 2a-7 and 38a-1, could be subject to disciplinary action for failure to comply with those rules.[19] (emphasis added)

Thus, while on the one hand the Commission appears to recognize that a written record-keeping requirement for each instance of "ongoing review" or "ongoing monitoring" would be burdensome, on the other hand the language quoted above implies that, since such ongoing review/monitoring may constitute a minimal credit risk determination, such record-keeping requirement would apply. The difficulty arises in part, we believe, from the establishment of a requirement (ongoing review/monitoring) for which no minimum compliance standards are specified in the Proposed Amendments, in contrast with the prior requirement of Rule 2a-7 mandating a credit quality review upon the downgrade of a security by an NRSRO. We recognize the difficulty faced by the Commission in having to delete a clear, event-driven review standard from the Rule, but the Committee believes that replacing it with standards based on principles of prudent portfolio management practice, whose interpretation and reach may vary in the view of different investment advisers, is problematic. We believe that providing some general requirements for such review in the Rule would assist advisers and Boards in carrying out their responsibilities, providing them with a clearer understanding of the standards by which their conduct will be measured.[20]

We believe that having requirements stated in the Rule would help promote greater uniformity in compliance practices and procedures among funds. Perhaps the ambiguity in the meaning of "determination" cited above could be addressed by making it clearer in the amended rule that procedures must be adopted for ongoing review/monitoring of factors affecting the credit risk of a fund's portfolio securities to determine whether a security or securities should be subjected to an updated minimal credit risk determination, and that while written records of actions taken in such ongoing monitoring/review process need not be maintained, the fund shall maintain written records of: (1) the general types of actions to be taken as part of such ongoing review/monitoring, including the expected frequency of such actions, and (2) any minimal credit risk determinations made with respect to a portfolio security as a result of such ongoing review/monitoring. We believe that our proposed language, above, may help to address that concern.

We would also encourage the Commission to provide greater clarity as to its expectations of the frequency and types of actions investment advisers to money market funds would be expected to take (and the fund's procedures would be expected to require them to take) under the rubric of

---

[19] Re-Proposing Release at footnote 109.

[20] For example, in the Re-Proposing Release, the Commission cites its Order Instituting Administrative Proceedings In the Matter of Ambassador Capital Management, LLC et al., Release No. IC-38089, Nov. 26, 2013, in which the investment adviser to a money market fund was accused of failure to comply with the requirements of Rule 2a-77(c)(11)(iii) to maintain a written record of its analysis and determination that a portfolio security presents minimal credit risk, although the Release refers to such determinations at the time of purchase of such portfolio securities and sheds no light on the Commission's thinking with respect to the circumstances, if any, that give rise under the Rule to any ongoing record-keeping requirements with respect to subsequent reviews of credit risk.

"ongoing monitoring" in proposed Rule 2a-7. Interestingly, the Commission addressed the issue as to the frequency of certain money market fund portfolio monitoring requirements with respect to the fairness of the valuation or pricing method for money market fund portfolio securities, in the commentary in the 1983 Adopting Release for Rule 2a-7:

> The rule [2a-7] does not prescribe specific intervals for such monitoring; however, the board [of the fund] must select intervals that are reasonable "in light of current market conditions." This means that the reviews should be frequent enough so that the board may become aware of changes in the market-based per share net asset value before they become material. During periods of high market volatility, this requirement may necessitate that the deviation between such market-based value and price be monitored on a daily basis. During periods of lower volatility, it may be reasonable to monitor such deviation less frequently. [21]

We believe it would be helpful if the Re-Proposing Release reiterated that guidance to support the creation of objective legal standards for compliance with the Rule, and confirmed that this continues to be the standard appropriate for money market funds that maintain a stable NAV. Additionally, under our suggested language for Rule 2a-7(h)(3), above, the distinction between "ongoing monitoring" and "determinations" as to credit risk would be clearer. For example, if the investment adviser's review/monitoring process, as approved by the fund's Board, were to include daily reviews of credit ratings of the fund's securities provided by NRSROs, it would be sufficient for purposes of Rule 2a-7(h)(3) that the written records of the monitoring/review procedures reflect that process, but it would not be necessary for the adviser to maintain documents showing the results of each daily review, unless, for example, a particular day's review showed a downgrade of a security by an NRSRO that triggered a minimal credit risk determination of that security by the investment adviser.

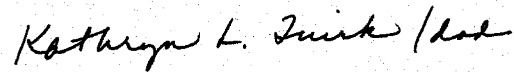
That 1983 Release further notes that Rule 2a-7does not prescribe specific intervals for such monitoring of the deviation between the market value of a security and the amortized cost valuation but that the fund's Board must select intervals that are reasonable "in light of current market conditions." The 1983 Release suggested that the reviews should be frequent enough that the board may become aware of changes in the market-based per share net asset value before they become material, which might necessitate that the deviation between such market-based value and price be monitored on a daily basis during periods of high market volatility (and it might be reasonable to do so less frequently during periods of lower volatility). We believe that a reiteration of those principles in the release adopting the Proposed Amendments would be helpful as well.

* * *

[21] 1983 Adopting Release, 48 Fed. Reg., No 138, at p. 32563.

The Committee appreciates the opportunity to comment on the Proposed Amendments. If we can be of any further assistance in this regard, please do not hesitate to contact the undersigned by telephone at 215-822-8320 or by e-mail at klquirk@comcast.net.

Very truly yours,



Kathryn L. Quirk, Chair
Committee on Investment Management Regulation

Drafting Committee:

Kenneth J. Berman
Paul Cellupica
Ronald M. Feiman
Robert I. Frenkel
Catherine E. Marshall
Dianne E. O'Donnell
Kathryn L. Quirk
Robert G. Zack

Annex A

Ben Archibald
Jennifer Avicolli
Kenneth J. Berman
Peter V. Bonanno
Gregory N. Bressler
Paul Cellupica
Clifford Cone
Laura A. Corsell
Donald R. Crawshaw
Ronald M. Feiman
Maureen Fialcowitz
Robert I. Frenkel
Daniel O. Hirsch
Nora M. Jordan
Patricia Louie
Janna Manes
Catherine E. Marshall
Lori A. Martin
Kathleen Moriarty
Richard F. Morris
James C. Munsell
Sean Murphy
Frank J. Nasta
Margery K. Neale
Dianne E. O'Donnell
Patrick Patalino
Thomas Phillips
Kathryn L. Quirk
Richard A. Rosen
Brian D. Simon
Seth Ruderman
Jeremy Smith
Patrick D. Sweeney
Emilie D. Wrapp
Robert G. Zack