Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule

AGENCY: Securities and Exchange Commission.

ACTION: Re-proposed rule; proposed rule.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is re-proposing certain amendments, initially proposed in March 2011, related to the removal of credit rating references in rule 2a-7, the principal rule that governs money market funds, and Form N-MFP, the form that money market funds use to report information to the Commission each month about their portfolio holdings, under the Investment Company Act of 1940 ("Investment Company Act" or "Act"). The re-proposed amendments would implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). We are issuing this re-proposal in consideration of comments received on our March 2011 proposal. In addition, we are proposing to amend rule 2a-7’s issuer diversification provisions to eliminate an exclusion from these provisions that is currently available for securities subject to a guarantee issued by a non-controlled person.

DATES: Comments should be received on or before [insert date 60 days after publication in the Federal Register.]

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:
• Use the Commission’s Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
• Send an e-mail to rule-comments@sec.gov. Please include File Number S7-07-11 on the subject line; or
• Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:
• Send paper comments to Kevin M. O’Neill, Deputy Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-07-11. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s Internet website (http://www.sec.gov/rules/proposed.shtml). Comments also are available for website viewing and printing in the Commission’s Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Erin C. Loomis, Senior Counsel; Amanda Hollander Wagner, Senior Counsel; Penelope W. Saltzman, Senior Special Counsel; Investment Company Rulemaking Office, at (202) 551-6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: We are proposing for public comment amendments to rule 2a-7 [17 CFR 270.2a-7] and Form N-MFP [17 CFR 274.201] under the Investment
Company Act.¹

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I. BACKGROUND

A. Credit Rating References

Section 939A of the Dodd-Frank Act requires each federal agency, including the Commission, 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.”² That section further provides

¹ Unless otherwise noted, all references to statutory sections are to the Investment Company Act, and all references to rules under the Investment Company Act, including rule 2a-7, will be to Title 17, Part 270 of the Code of Federal Regulations [17 CFR 270].

² Pub. L. No. 111-203 § 939A(a)(1)-(2). Section 939A of the Dodd-Frank Act applies to all federal
that each such agency shall “modify any such regulations identified by the review . . . to remove 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.”

As a step toward implementing these mandates, in March 2011 we proposed to replace references to credit ratings issued by nationally recognized statistical rating agencies (“NRSROs”) in two rules and four forms under the Securities Act of 1933 (“Securities Act”) and the Investment Company Act, including rule 2a-7 and Form N-MFP under the Investment Company Act. The 2011 proposal preceded other amendments to rule 2a-7 and Form N-MFP agencies.

3 Pub. L. No. 111-203 § 939A(b). Section 939A of the Dodd Frank Act provides that agencies shall seek to establish, to the extent feasible, uniform standards of creditworthiness, taking into account the entities the agencies regulate and the purposes for which those entities would rely on such standards.

4 See References to Credit Ratings in Certain Investment Company Act Rules and Forms, Investment Company Act Release No. 29592 (Mar. 3, 2011) [76 FR 12896 (Mar. 9, 2011)] (“2011 Proposing Release”). Specifically, we proposed to: (i) remove references to credit ratings in rules 2a-7 and 5b-3 under the Investment Company Act and replace them with alternative standards of creditworthiness; (ii) adopt new rule 6a-5 under the Investment Company Act that would establish a creditworthiness standard to replace the credit rating reference in section 6(a)(5) removed by the Dodd-Frank Act; (iii) eliminate required disclosures of credit ratings in Form N-MFP under the Investment Company Act; and (iv) remove the requirement that credit ratings be used when portraying credit quality in shareholder reports from Forms N-1A, N-2, and N-3 under the Securities Act and the Investment Company Act. In December 2013, we adopted amendments removing references to credit ratings in rule 5b-3 and eliminating the required use of credit ratings in Forms N-1A, N-2, and N-3. See Removal of Certain References to Credit Ratings under the Investment Company Act, Investment Company Act Release No. 30847 (Dec. 27, 2013) [79 FR 1316 (Jan. 8, 2014)] (“2013 Ratings Removal Adopting Release”). We adopted new rule 6a-5 on November 19, 2012. See Purchase of Certain Debt Securities by Business and Industrial Development Companies Relying on an Investment Company Act Exemption, Investment Company Act Release No. 30268 (Nov. 19, 2012) [77 FR 70117 (Nov. 23, 2012)]. Rule 3a-7 under the Investment Company Act also contains a reference to ratings. In August 2011, in a concept release soliciting comment on the treatment of asset-backed issuers under the Investment Company Act, we sought comment on the role, if any, that credit ratings should continue to play in the context of rule 3a-7. See Treatment of Asset-Backed Issuers under the Investment Company Act, Investment Company Act Release No. 29779 (Aug. 31, 2011) [76 FR
that we proposed last year as part of our broader efforts to reform money market funds. At that time, we noted that we were not rescinding our 2011 proposal to remove ratings references from certain rules and forms under the Investment Company Act, but that we intended to address the matter at another time.

We received several comments on the 2013 Money Market Fund Proposing Release suggesting that we act on credit ratings as part of our broader money market fund reforms. And today in another release, we have adopted certain amendments to rule 2a-7 and Form N-MFP that we proposed last year. We also received comments on the 2011 Proposing Release that raised a number of concerns with respect to the proposed amendments and suggested alternative rule text for some provisions. We have determined to re-propose amendments to replace references to credit ratings in rule 2a-7 and to modify provisions in Form N-MFP that reference

5 See Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 30551 (June 5, 2013) [78 FR 36834 (June 19, 2013)] (“2013 Money Market Fund Proposing Release”). The 2013 rule proposals were designed to address money market funds’ susceptibility to heavy redemptions, improve their ability to manage and mitigate potential contagion from such redemptions, and increase the transparency of their risks, while preserving, as much as possible, the benefits of money market funds.

6 Id. at text accompanying n.130.


Unless otherwise noted, all references to rule 2a-7 and Form N-MFP in this release refer to rule 2a-7 and Form N-MFP as amended by the 2014 Money Market Fund Adopting Release. References to provisions of rule 2a-7 and Form N-MFP as they would be modified by the amendments we re-propose in this release are preceded by the term “re-proposed” (i.e., “re-proposed rule 2a-7”).
credit ratings, in consideration of the mandate of Dodd-Frank Act section 939A, the comments on the 2011 Proposing Release, and the broader money market fund reforms we have adopted today.\(^9\)

A number of other federal agencies have also taken action to implement section 939A of the Dodd-Frank Act, including regulations proposed or adopted by the Commodity Futures Trading Commission, the Office of the Comptroller of the Currency (“OCC”), the National Credit Union Administration, the Federal Housing Finance Agency, the Department of Labor, and jointly by the OCC and Board of Governors of the Federal Reserve.\(^{10}\) In some of these initiatives, the references to ratings were or would be replaced with an alternative standard designed to retain the same degree of credit quality as reflected by the use of credit ratings. We have considered the actions taken by these other regulators in re-proposing the amendments discussed in this release.

**B. Exclusion from the Issuer Diversification Requirement**

As noted above, today we adopted amendments to rule 2a-7 as part of our broader money market fund reforms. These included amendments relating to the rule’s diversification

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\(^9\) As discussed above, the Commission is not re-opening comment on amendments to rule 2a-7 that were adopted in the 2014 Money Market Fund Adopting Release. See supra note 8.

provisions, which require a money market fund to diversify its investments with respect to issuers of the securities it acquires, as well as providers of demand features and guarantees related to those securities. As discussed in the 2014 Money Market Fund Adopting Release,\textsuperscript{11} we sought comment on specific amendments we proposed as well as more broadly on the issuer and guarantor diversification requirements. Some of the comments we received in response prompted us to re-evaluate the exclusion to the issuer diversification requirement for securities subject to a guarantee issued by a non-controlled person. After careful consideration, and consistent with our reform goal of limiting concentrated exposure of money market funds to particular economic enterprises, we are proposing amendments that would eliminate this exclusion from the issuer diversification requirement of rule 2a-7.

II. DISCUSSION

A. Rule 2a-7

The Investment Company Act and applicable rules generally require investment companies ("funds") to calculate current net asset value per share by valuing their portfolio instruments at market value or, if market quotations are not readily available, at fair value as determined in good faith by the board of directors.\textsuperscript{12} These valuation requirements are designed to prevent unfair share pricing from diluting or otherwise adversely affecting the interests of investors.\textsuperscript{13} Rule 2a-7 under the Investment Company Act, which governs the operation of

\begin{footnotesize}
\textsuperscript{11} See 2014 Money Market Fund Adopting Release, supra note 7, at section III.I.1.d.
\textsuperscript{12} See section 2(a)(41) of the Investment Company Act (defining value), rule 2a-4 (defining current net asset value), and rule 22c-1 (generally requiring open-end funds to sell and redeem their shares at a price based on the funds’ current net asset value as next computed after receipt of a redemption, purchase, or sale order).
\textsuperscript{13} If shares are sold or redeemed based on a net asset value that has been either understated or overstated compared to the amount at which portfolio instruments could have been sold, then the interests of either existing shareholders or new investors will have been diluted. See Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release
money market funds, exempts certain money market funds from these valuation requirements. Until today, all money market funds have been permitted to value their portfolio securities using the amortized cost method of valuation ("amortized cost method") and to use the penny-rounding method of pricing ("penny-rounding method") to maintain a stable share price, typically $1.00 per share. After the amendments adopted today go into effect, however, institutional prime and institutional municipal money market funds (collectively, "institutional prime funds") will be required to sell and redeem shares at their net asset value calculated on the current market-based value of the securities in their underlying portfolios, rounded to the fourth decimal place (e.g.,

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14 Under the amortized cost method, portfolio instruments are valued by reference to their acquisition cost as adjusted for amortization of premium or accretion of discount. See rule 2a-7(a)(2). Share price is determined under the penny-rounding method by valuing securities at market value, fair value or amortized cost and rounding the per share net asset value to the nearest cent on a share value of a dollar, as opposed to the nearest one tenth of one cent as otherwise would be required. See Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), Investment Company Act Release No. 13380 (July 11, 1983) [48 FR 32555 (July 18, 1983)] ("1983 Adopting Release"), at n.6 ("Release 9786 sets the amount of less than 1/10 of one cent on a share value of one dollar as the benchmark for materiality."); Valuation of Debt Instruments by Money Market Funds and Certain Other Open-End Investment Companies, Investment Company Act Release No. 9786 (May 31, 1977) [42 FR 28999 (June 7, 1977)] at text accompanying n.11; rule 2a-7(a)(20) (defining penny-rounding method).

While most money market funds maintain a stable net asset value ("NAV"), some fund sponsors have established floating NAV money market funds in past years. See Northern Trust Files to Launch Investors Variable NAV Money Funds, Crane Data (Dec. 31, 2012), http://cranedata.com/archives/all-articles/4314/.

15 As part of these amendments, the Commission has amended rule 2a-7 to rescind the exemptions that previously permitted institutional prime funds (i.e., money market funds other than government and retail money market funds, including municipal money market funds that fall under the definition of "retail money market fund" under rule 2a-7 as amended) to maintain a stable share price by use of amortized cost valuation and/or penny rounding. See 2014 Money Market Fund Adopting Release, supra note 8, at section III.B.
$1.000016), i.e., transact at a “floating” net asset value per share (“NAV”).

Rule 2a-7 contains “risk limiting” provisions designed to minimize the amount of risk a money market fund may assume. For those funds that are permitted to maintain a stable share price, these conditions help reduce the deviation between a money market fund’s stabilized share price and the market value of its portfolio. For floating NAV funds, these conditions help to limit the risk of loss by, among other things, reducing principal volatility. Any fund that holds itself out to investors as a money market fund or the equivalent of a money market fund also must comply with these conditions. Among these conditions, rule 2a-7 limits a money market fund’s portfolio investments to “eligible securities,” or securities that have received credit ratings from the “requisite NRSROs” in one of the two highest short-term rating categories or comparable unrated securities. A requisite NRSRO is an NRSRO that a money market fund’s board of directors has designated for use (a “designated NRSRO”) and that issues credit ratings that the board determines, at least annually, are sufficiently reliable for the fund to use in determining the eligibility of portfolio securities. Rule 2a-7 further restricts money market

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16 A money market fund could also price its shares at an equivalent or more precise level of accuracy for funds with a different share price. For example, a money market fund with a $10 target share price could price its shares at $10.000. See rule 2a-7(c)(1)(ii).

17 See 2014 Money Market Fund Adopting Release, supra note 8, at section III.B. We note that the compliance date for the floating NAV amendments adopted in the 2014 Money Market Fund Adopting Release is three years after the amendments’ effective date.

18 Rule 2a-7 contains conditions that apply to each investment a money market fund proposes to make, as well as conditions that apply to a money market fund’s entire portfolio. Although institutional prime funds are no longer permitted to maintain a stable share price by use of amortized cost valuation and/or penny rounding, these funds remain subject to the “risk limiting” provisions of rule 2a-7.

19 See rule 2a-7(b) (prohibiting a fund from holding itself out as a money market fund unless it complies with the provisions of rule 2a-7, including the risk limiting conditions of rule 2a-7(d)).

20 See rule 2a-7(d)(2)(i). The term “eligible security” is defined in rule 2a-7(a)(12).

21 See rule 2a-7(a)(11) (defining “designated NRSRO”); rule 2a-7(a)(24) (defining “requisite NRSRO”).
funds to securities that the fund’s board of directors (or the board’s delegate\textsuperscript{22}) determines present minimal credit risks, and specifically requires that determination “be based on factors pertaining to credit quality in addition to any ratings assigned to such securities by an NRSRO.”\textsuperscript{23} A money market fund is required to invest at least 97 percent of its total assets in eligible securities that have received a rating from the requisite NRSROs in the highest short-term rating category for debt securities (“first tier securities”\textsuperscript{24}) or unrated securities of comparable quality.\textsuperscript{25}

To implement the mandate of Dodd-Frank Act section 939A, we are re-proposing amendments to remove references to credit ratings in rule 2a-7. The re-proposed amendments would affect five elements of the rule: (i) determination of whether a security is an eligible security; (ii) determination of whether a security is a first tier security; (iii) credit quality

\textsuperscript{22} A money market fund board may delegate minimal credit risk determinations, and typically does to the fund’s adviser, provided that the board retains sufficient oversight. See rule 2a-7(j); Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 18005 (Feb. 20, 1991) [56 FR 8113 (Feb. 27, 1991)] (“1991 Adopting Release”) (permitting a money market fund’s board of directors to delegate the responsibility to make such determinations). See also INVESTMENT COMPANY INSTITUTE, REPORT OF THE MONEY MARKET WORKING GROUP (Mar. 17, 2009) (“ICI WORKING GROUP REPORT”), available at http://www.ici.org/pdf/ppr_09_mmwg.pdf, at Appendix I (“In our experience, Boards uniformly delegate the determination of minimal credit risks to their fund’s adviser.”); Comment Letter of Mutual Fund Directors Forum (Apr. 25, 2011) (“MFDF Comment Letter”) (“as we have consistently commented in the past, ... money fund boards will not themselves determine the creditworthiness of individual money market securities. Rather consistent with the provisions of rule 2a-7, boards will delegate this task in virtually all circumstances to the fund’s adviser.”). When discussing or requesting comment on policies, procedures or practices regarding minimal credit risk determinations, this release identifies fund advisers as making the determinations. Comments on the 2011 Proposing Release are available at: http://www.sec.gov/comments/s7-07-11/s70711.shtm.

\textsuperscript{23} Rule 2a-7(d)(2)(i). Thus, under the current rule, if the security is rated, having the requisite NRSRO rating is a necessary but not sufficient condition for investing in the security and cannot be the sole factor considered in determining whether a security presents minimal credit risks. See 1991 Adopting Release, supra note 22, at text preceding n.18.

\textsuperscript{24} See rule 2a-7(a)(14) (defining “first tier security”).

\textsuperscript{25} See rule 2a-7(d)(2)(ii) (prohibiting a fund immediately after the acquisition of any second tier security from holding more than 3% of its total assets in second tier securities).
standards for securities with a conditional demand feature; (iv) requirements for monitoring securities for ratings downgrades and other credit events; and (v) stress testing. The re-proposed amendments to rule 2a-7 reflect our consideration of commenters’ concerns and suggested modifications to our 2011 proposal, as well as the broader money market fund reforms we have adopted today. These re-proposed amendments are designed to remove references to, or requirement of reliance on, credit ratings in rule 2a-7 and to substitute standards of creditworthiness that we believe are appropriate.

1. Eligible Securities

In 2011, we proposed to eliminate the requirement that eligible securities be rated. Instead, the Commission would have required that fund boards: first, determine whether securities are eligible securities based on minimal credit risks; and second, distinguish between first and second tier securities based on subjective standards similar to those the ratings agencies have developed to describe their ratings. We requested comments on this proposal, including comments on whether the Commission should limit money market funds to investing in securities solely based on a minimal credit risk determination, i.e., establish a single test for determining whether a fund could invest in a security.

A number of commenters objected to our proposal to retain the distinction between first and second tier securities. They asserted that these proposed amendments were (i) unworkable

26 The re-proposed amendments also would make conforming amendments to rule 2a-7’s recordkeeping and reporting requirements. See re-proposed rule 2a-7(h)(3).

27 In addition, we are re-proposing a technical revision that would update a cross-reference in rule 2a-7(a)(5) to reflect amendments to rule 5b-3 adopted last year. See supra note 4.


29 See id. at section II.A.1.

30 See, e.g., Comment Letter of Calvert Group, Ltd. (Apr. 25, 2011); Comment Letter of The Dreyfus Corporation (Apr. 25, 2011) (“Dreyfus Comment Letter”); Comment Letter of
because of the difficulty in differentiating between first and second tier securities and
(ii) redundant because the amendments would require fund boards and their advisers to apply
almost indistinguishable subjective judgments in determining whether securities were both
eligible securities and first tier securities.\footnote{See, e.g., Comment Letter of Fidelity Investments (Apr. 28, 2011) (“Fidelity Comment Letter”) (“Under the [p]roposed [r]ule, tier categorizations will no longer be determined by a clear, objective standard based on published credit rating agency ratings; rather, that determination will be put in the hands of myriad money market mutual funds, and a fund’s standards for the first and second tiers could change from month to month, or even week to week . . . result[ing] in less predictability and more confusion for investors seeking a stable and consistent product . . . .”); Schwab Comment Letter, supra note 30 (“[the retention of first tier and second tier securities,] given the elimination of credit ratings, is redundant with the investment adviser’s ongoing obligation to monitor for minimal credit risks.”).} Instead, they urged that we combine the two criteria
and require a single, uniform, very high standard of quality.\footnote{See ICI Comment Letter, supra note 30; Schwab Comment Letter, supra note 30; T. Rowe Price Comment Letter, supra note 30. But see MFDF Comment Letter, supra note 22 (advocating maintaining the distinction between first and second tier securities as a risk-limiting condition in rule 2a-7, but questioning the usefulness of the distinction between first and second tier securities when the proposed description of the difference “comes dangerously close to establishing a distinction that is more semantic than substantive”).} Specifically, several commenters
suggested that the rule define an “eligible security” to mean a security with a remaining maturity
of 397 calendar days or less that the fund’s board of directors (or the board’s delegate)
determines presents minimal credit risks and include a determination that the security’s issuer
has “the highest capacity” or “a strong capacity” to meet its short-term obligations.\footnote{See ICI Comment Letter, supra note 30 (recommending that the Commission adopt a “strong capacity” standard as an appropriate substitute for the credit rating references in rule 2a-7, noting that this standard reflects certain NRSROs’ highest short-term rating category, but also recommending that the Commission adopt an “exceptionally strong capacity” standard, which}
commenters noted that securities meeting this uniform standard would be generally comparable to securities rated in the highest short-term rating category, which are first tier securities under current rule 2a-7.34

After consideration of the comments and the statutory directive to eliminate references to ratings in our rules, and to seek consistent standards of creditworthiness to the extent feasible, we are re-proposing amendments to rule 2a-7. The re-proposal would combine the two risk criteria into a single standard, which would be included as part of rule 2a-7’s definition of eligible security.35 As re-proposed, an eligible security would be a security with a remaining maturity of 397 calendar days or less that the fund’s board of directors (or its delegate) determines presents minimal credit risks, which determination includes a finding that the security’s issuer has an exceptionally strong capacity to meet its short-term obligations.36 Thus, under our re-proposal, a

would be consistent with the definitions used by many NRSROs to define their highest long-term category, as an alternative substitute for the credit rating references in rule 5b-3); Vanguard Comment Letter, supra note 30 (advocating a determination that the issuer have the “highest capacity” to meet those obligations).

34 See id.

35 Currently, the requirement that the fund board (or its delegate) determine that a security presents minimal credit risks is set forth in rule 2a-7(d)(2)(i) (requiring that the determination of minimal credit risk be based on factors pertaining to credit quality in addition to any rating assigned by a designated NRSRO). Under our re-proposal, the definition of eligible security in the rule would be restructured to include the minimal credit risk determination, and would include government securities and securities issued by money market funds, which are currently included in the definition of first tier security. See rule 2a-7(a)(14).

36 Re-proposed rule 2a-7(a)(11). The re-proposal would make a conforming change to the recordkeeping requirements under the rule to reflect that funds must retain a written record of the determination that a portfolio security is an eligible security, including the determination that it presents minimal credit risks. See re-proposed rule 2a-7(h)(3).

The re-proposal also would eliminate the following defined terms from the rule: “designated NRSRO,” “first tier security,” “rated security,” “requisite NRSROs,” “second tier security,” and “unrated security.” It also would revise a number of provisions in the rule that currently reference these terms. See rule 2a-7(a)(12) (eligible security); rule 2a-7(d)(2) (portfolio quality); rule 2a-7(d)(3)(i)(A)(1) and (C) (portfolio diversification); rule 2a-7(d)(3)(iii)(C) (portfolio diversification); rule 2a-7(f)(1) (downgrades); rule 2a-7(h)(3) (record keeping and reporting); rule 2a-7(j) (delegation).
money market fund would be limited to investing in securities that the fund’s board (or its
delegate) has determined present minimal credit risks, notwithstanding any rating the security
may have received. In addition, fund boards would no longer be required to designate
NRSROs. The 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, while limiting a money market fund’s investments in
second tier securities to those the fund determines do not diminish the overall high quality of the
fund’s portfolio.

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37 Nor would fund boards have to disclose designated NRSROs in the statement of additional
information ("SAI"). We note that after enactment of the Dodd-Frank Act, our staff issued a
no-action letter assuring money market funds and their managers that, in light of section 939A,
the staff would not recommend enforcement action under section 2(a)(41) of the Act and rules
2a-4 and 22c-1 thereunder if a money market fund board did not designate NRSROs and did not
make related disclosures in the fund’s SAI before the Commission had completed its review of
rule 2a-7 required by the Dodd-Frank Act and made any modifications to the rule. See SEC Staff

38 See Fitch Ratings, Definitions of Ratings and Other Forms of Opinion, Jan. 2014,
http://www.fitchratings.com/web_content/ratings/fitch_ratings_definitions_and_scales.pdf
(“Fitch Ratings Scales”), at 18 (stating that a rating of F1 “[i]ndicates the strongest intrinsic
capacity for timely payments of financial commitments”); Moody’s Investor Service, Rating
Symbols and Definitions, Apr. 2014,
Rating Definitions”), at 6 (stating that Prime-1 issuers “have a superior ability to repay short-term
debt obligations”); Standard & Poor’s, Standard & Poor’s Ratings Definitions, Apr. 27, 2011,
Definitions”), at 5 (stating that for a rating of A-1, “[t]he obligor’s capacity to meet its financial
commitment on the obligation is strong”).

39 A number of commenters expressed concern that the standards proposed in 2011 would
simultaneously raise the standards for first tier securities and weaken the standards for second tier
securities. See ICI Comment Letter, supra note 30; T. Rowe Price Comment Letter, supra note
30; Dreyfus Comment Letter, supra note 30. Each of these comments notes that the proposed
standard that a first tier security issuer or guarantor have the “highest” capacity to meet its
short-term obligations could raise the standard above that in the current rule because this
standard, if taken literally, does not contemplate any variation in creditworthiness among issuers
of first tier securities. In contrast, the current definition of first tier security refers to issuers and
guarantors falling within a certain range of capacities to repay their short-term obligations. These
comments also maintain that the proposed standard for second tier securities, which was not tied
to minimum rating requirements, could permit a fund to invest in securities that would not be
As a result of the single standard and elimination of the distinction between first and second tier securities we are re-proposing, we also are re-proposing to remove the current prohibition on funds investing more than 3 percent of their portfolios in second tier securities.\footnote{See rule 2a-7(d)(2)(ii). In conforming changes, we re-propose to move the requirement currently in the definition of eligible security that the issuer of a demand feature or guarantee promptly notify the holder of the security in the event the demand feature or guarantee is substituted with another demand feature or guarantee (if such substitution is permissible) to the paragraphs of the rule that address securities subject to guarantees and conditional demand features. \textit{Compare} rule 2a-7(a)(12)(iii)(B) \textit{with} re-proposed rules 2a-7(d)(2)(ii) and 2a-7(d)(2)(iii)(D).} In 2010, we imposed greater limits on investments in second tier securities because they may experience greater price volatility and illiquidity than first tier securities in times of market stress, which could adversely affect a money market fund’s ability to maintain a stable net asset value.\footnote{See \textit{Money Market Fund Reform}, Investment Company Act Release No. 29132 (Feb. 23, 2010) [75 FR 10060 (Mar. 4, 2010)] (‘‘2010 Money Market Fund Adopting Release’’), at nn.52-53 and accompanying text (explaining that second tier securities are subject to greater spread risk and trade in thinner markets than first tier securities and noting that second tier securities are more likely to be downgraded than first tier securities).} Nevertheless, as we acknowledged in 2010, investors could benefit from these investments to the extent that a money market fund could conclude, after a thorough risk analysis, that second tier securities provide a higher yield than first tier securities while maintaining a risk profile consistent with the fund’s investment objectives.\footnote{See \textit{id.} at text accompanying and following n.54.} By eliminating the rule’s current limitations on investments in second tier securities, funds theoretically could invest in second tier securities to a greater extent than permitted today.\footnote{See rule 2a-7(c)(3)(ii). Money market funds also are limited from investing more than $\frac{1}{2}$% of their assets in second tier securities of a single issuer and 2.5% of their portfolios in second tier securities issued, guaranteed or subject to a demand feature issued by the same entity. \textit{See} rule 2a-7(d)(3)(i)(C) and rule 2a-7(d)(3)(iii)(C). These limits also would be eliminated under our re-proposal.} The re-proposed standard, however, is designed to preserve the current degree of risk limitation in rule 2a-7 without eligible securities under the current rule.
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). 44

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.

In determining whether a security presents minimal credit risks, a fund adviser could take into account credit quality determinations prepared by outside sources, including NRSRO ratings, that the adviser considers are reliable in assessing credit risk. In considering such sources, an adviser should understand the particular NRSRO’s methodology for determining the rating at issue and make an independent judgment of credit risks, and it should consider any outside source’s record with respect to evaluating the types of securities in which the fund invests.

44 See ICI Comment Letter, supra note 30 (stating that the Dodd-Frank Act “does not leave any means of explicitly limiting acquisitions of securities rated below the highest category [but a single, uniform, very high standard] would at least require money market funds to determine that such securities do not diminish the overall credit quality of their portfolios”).

45 See Fitch Ratings Scales, supra note 38, at 18 (a rating of F3 indicates the “intrinsic capacity for timely payment of financial commitments is adequate.”); Moody’s Rating Definitions, supra note 38, at 6 (“Issuers (or supporting institutions) rated Prime-3 have an acceptable ability to repay short-term debt obligations.”); S&P Ratings Definitions, supra note 38, at 5 (“A short-term obligation rated ‘A-3’ exhibits adequate protection parameters.”).
We request comment on consolidating the credit quality standard and eliminating the distinction between first and second tier securities. Do commenters believe that the re-proposed standard is an appropriate standard of creditworthiness for rule 2a-7? Is the re-proposed “exceptionally strong capacity” standard an appropriate substitute for credit ratings in rule 2a-7? Is there another standard that would be a more appropriate substitute for credit ratings in rule 2a-7? Would 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 sufficient clarity for money market fund boards and advisers making credit quality determinations? Would such a standard impact investors’ understanding of credit quality? Would it promote greater or less uniformity in credit quality determinations among funds than the standard we proposed in 2011? Would the 2011 proposal establish risk limitations more in line with those provided under the current rule? Is there an alternative standard for making credit quality determinations that is more objective than the re-proposed standard? We note that no commenters provided suggestions when we sought comment in the 2011 proposal on alternatives that would provide a more objective evaluation of credit quality; have commenters’ positions on this issue evolved since 2011?

We also request specific comment on the finding, required as part of the minimal credit risk determination, that the security’s issuer has an exceptionally strong capacity to meet its short-term financial obligations. What impact is this proposed standard likely to have on the overall risk of money market fund portfolios? What impact is this re-proposed “exceptionally strong capacity” standard likely to have on money market fund acquisitions of first tier securities? Does it permit sufficient variation among the most creditworthy issuers? Similarly, what impact is the re-proposed “exceptionally strong capacity” standard likely to have on money
market fund acquisitions of second tier securities? Will this re-proposed standard, and the elimination of the distinction between first and second tier securities in rule 2a-7, lead money market funds to acquire more second tier securities than they do currently? Would a finding that a security’s issuer instead has a “superior,” “very strong,” or “strong” capacity to meet its short-term financial obligations better reflect the current risk limitation in rule 2a-7, or would it result in a standard that is less stringent than under the current rule? Our goal is to preserve a similar degree of risk limitation as in the current rule, and we note that the phrase “strong capacity” reflects the standard that one NRSRO articulates for securities with a second tier rating.46

As discussed above, we believe that the re-proposed standard would preclude funds from investing in securities rated third tier (or comparable unrated securities).47 Do funds agree? We do not believe that the re-proposed standard should significantly affect money market funds’ investment in unrated securities because we understand that money market funds hold few unrated securities.48 We request comment about the potential reasons for this current practice. Specifically, is there currently a limited supply of unrated securities that qualify as eligible securities, or do money market funds hold few unrated securities for other reasons (e.g., investor or board of directors’ requirements for ratings)? Would money market funds invest in more unrated securities under our re-proposed amendments?

As discussed in the 2014 Money Market Fund Adopting Release, we recognize that

46 See Moody’s Rating Definitions, supra note 38, at 6 (“Issuers (or supporting institutions) rated Prime-2 have a strong ability to repay short-term debt obligations.”).

47 See supra note 45 and accompanying text.

48 Based on Form N-MFP filings from February 28, 2014, we estimate that 0.005% of money market fund assets under management were invested in unrated securities. Many securities that funds list as unrated in Form N-MFP filings actually are issued as part of a rated program or have an issuer or guarantor that is rated. See rule 2a-7(a)(22)(i), (ii) (defining “rated security” to include a security that has received the requisite short-term rating from a designated NRSRO, or that is issued by an issuer or has a guarantee with such a rating).
certain of the amendments to rule 2a-7 adopted today could affect money market fund managers’ investment decisions. Under the newly adopted amendments to rule 2a-7, certain money market funds would be required to transact using a floating NAV. Managers of floating NAV funds, in an effort to limit volatility, might further limit their investments in relatively riskier portfolio securities, or conversely, in an effort to increase yield, might increase their investments in such securities. As described in more detail below, we request comment on the extent to which the re-proposed standard may affect the potential incentive for certain funds to invest in riskier securities (i.e., those securities that would be second tier under current rule 2a-7). Would a finding that issuers have an “exceptionally strong capacity” to meet their short-term obligations mitigate any risks associated with floating NAV funds’ potential incentives to invest in riskier securities? Would a finding that issuers have a “superior,” “very strong,” or “strong” repayment ability be a sufficient risk mitigant?

Also under the amendments to rule 2a-7 we adopted today, all money market funds (including those still able to transact at a stable NAV) will be required to disclose daily the market value of their portfolios generally to the fourth decimal place.49 If a money market fund were to invest to a greater extent than its peer funds in riskier second tier securities, then that fund would have greater volatility in price or market value of its shares, as compared to the volatility and price of its peer funds’ shares. We request comment on whether potential incentives for increased investments in riskier second tier securities would be reduced by market discipline resulting from these newly required disclosures.

49 See rule 2a-7(h)(10)(iii); 2014 Money Market Fund Adopting Release, supra note 8, at section III.E.9.c. To the extent a money market fund prices its shares using a share price other than $1.0000, it would be required to disclose its share price at an equivalent level of accuracy. See rule 2a-7(h)(10)(iii). See also supra note 16 and accompanying text.
Rule 2a-7 does not set forth any specific factors that a board (or its delegate) should consider in determining minimal credit risks. In response to our 2011 proposal to replace an objective standard of an NRSRO rating for eligible securities with a subjective standard, some commenters advocated that we develop specific guidance in connection with assessments of credit quality. We have provided guidance before regarding certain factors to be considered in minimal credit risk determinations for asset-backed securities under rule 2a-7 and in our release removing references to credit ratings from the net capital rule under the Securities Exchange Act of 1934. Commission staff also has provided guidance in the past on factors that a board could consider in performing credit assessments under rule 2a-7.

Our staff also has had opportunities to observe how money market fund advisers evaluate minimal credit risk through its examinations of money market funds. Although staff has noted a range in the quality and breadth of credit risk analyses among the money market funds examined, staff has also observed that when performing their minimal credit risk determinations, most of


51 See 2010 Money Market Fund Adopting Release, supra note 41, at section II.3; Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934, Securities Exchange Act Release No. 71194 (Dec. 27, 2013) [79 FR 26550 (Jan. 8, 2014)] (“2013 Net Capital Rule Amendments”) at section II.B.1.a.iii (listing certain factors a broker-dealer could consider, as appropriate, under policies and procedures it establishes to assess whether a security or money market instrument has only a minimal amount of credit risk for purposes of rule 15c3-1 under the Securities Exchange Act of 1934). See also Comment Letter of Consumer Federation of America (Apr. 25, 2011) (suggesting the proposed standard could provide a limitation on money market fund firms’ investments by requiring fund boards to review specific types of objective data that credit rating agencies and other risk assessment specialists consider in developing credit ratings); Comment Letter of Colorado Public Employees’ Retirement Association (Apr. 21, 2011) (advocating that any approach to replacing credit ratings contain quantitative and qualitative elements with certain specific characteristics).

the advisers to these funds evaluate some common factors that bear on the ability of an issuer or guarantor to meet its short-term financial obligations. Based on the staff’s experience and in consideration of general criteria included in recommendations by an industry money market working group of best practices for making minimal credit risk determinations, we believe that an assessment of the strength of any issuer’s or guarantor’s ability to satisfy these obligations generally should include an analysis of the following factors to the extent appropriate: (i) the issuer or guarantor’s financial condition, i.e., analysis of recent financial statements, including trends relating to cash flow, revenue, expenses, profitability, short-term and total debt service coverage, and leverage (including financial leverage and operating leverage); (ii) the issuer or guarantor's liquidity, including bank lines of credit and alternative sources of liquidity; (iii) the issuer or guarantor’s ability to react to future events, including a discussion of a “worst case scenario,” and its ability to repay debt in a highly adverse situation; and (iv) the strength of the issuer or guarantor’s industry within the economy and relative to economic trends as well as the issuer or guarantor’s competitive position within its industry (including diversification in sources of profitability, if applicable). In addition, a minimal credit risk evaluation could include an

__53__ Under the current rule, a security may be determined to be an eligible security or a first tier security based solely on whether the guarantee is an eligible security or a first tier security, as the case may be. Rule 2a-7(d)(2)(ii).

__54__ ICI WORKING GROUP REPORT, supra note 22, at Appendix I.

__55__ Under the current rule, when a security’s maturity is determined with reference to a demand feature, the fund’s board of directors must perform an ongoing review of the security’s continued minimal credit risks, and that review must be based on, among other things, financial data for the most recent fiscal year of the demand feature’s issuer. Rule 2a-7(g)(3).

__56__ Many of these considerations have been included in staff guidance as well as in best practices for determining minimal credit risk set forth in the Report of the Money Market Working Group submitted to the Board of Governors of the Investment Company Institute in 2009. See 1990 Staff Letter, supra note 52 (advising registrants that in the staff’s view a board of directors can only make a minimal credit risk determination regarding a security based on an analysis of the issuer’s capacity to repay its short-term debt, which analysis would include: (i) a cash flow
analysis of whether the price and/or yield of a security is similar to that of other securities in the fund’s portfolio.\(^{57}\)

The staff has also observed other factors that money market fund advisers may take into account when evaluating minimal credit risks of particular asset classes. To the extent applicable, fund advisers may wish to consider the following additional factors:

- For municipal securities: (i) sources of repayment; (ii) issuer demographics (favorable or unfavorable);\(^{58}\) (iii) the issuer’s autonomy in raising taxes and revenue; (iv) the issuer’s reliance on outside revenue sources, such as revenue from a state or federal government entity; and (v) the strength and stability of the supporting economy.\(^{59}\)

\(^{57}\) See 2013 Net Capital Rule Amendments, \textit{supra} note 51, at second paragraph preceding n.99.

\(^{58}\) Demographics could include considerations such as the type, size, diversity and growth or decline of the local government’s tax base, including income levels of residents, and magnitude of economic activity.

\(^{59}\) See 1989 Staff Letter, \textit{supra} note 52 (additional factors such as sources of repayment, autonomy in raising taxes and revenue, reliance on outside revenue sources and strength and stability of the
• For conduit securities under rule 2a-7:60 analysis of the underlying obligor as described above for all securities except asset backed securities (including asset backed commercial paper).61

• For asset backed securities (including asset backed commercial paper): (i) analysis of the underlying assets to ensure they are properly valued and that there is adequate coverage for the cash flows required to repay the asset backed security under various market conditions; (ii) analysis of the terms of any liquidity or other support provided; and (iii) legal and structural analyses to determine that the particular asset backed security involves no more than minimal credit risks for the money market fund.62

• For other structured securities, such as variable rate demand notes,63 tender option bonds,64 extendible bonds65 or “step up” securities,66 or other structures, in addition to

supporting economy should be considered with respect to tax-exempt securities); OCC Guidance, supra note 56.

Under rule 2a-7, a “conduit security” means a security issued by a municipal issuer involving an arrangement or agreement entered into, directly or indirectly, with a person other than a municipal issuer, which arrangement or agreement provides for or secures repayment of the security. Rule 2a-7(a)(7). A “municipal issuer” is defined under the rule to mean a state or territory of the United States (including the District of Columbia), or any political subdivision or public instrumentality of a state or territory of the United States. Id. A conduit security does not include a security that is: (i) fully and unconditionally guaranteed by a municipal issuer; (ii) payable from the general revenues of the municipal issuer or other municipal issuers (other than those revenues derived from an agreement or arrangement with a person who is not a municipal issuer that provides for or secures repayment of the security issued by the municipal issuer); (iii) related to a project owned and operated by a municipal issuer; or (iv) related to a facility leased to and under the control of an industrial or commercial enterprise that is part of a public project which, as a whole, is owned and under the control of a municipal issuer. Id.

See OCC Guidance, supra note 56 (OCC credit risk factors for revenue bonds include consideration of the obligor’s financial condition and reserve levels).


A variable rate demand obligation (which includes variable rate demand notes) is a security for which the interest rate resets on a periodic basis and holders are able to liquidate their security through a “put” or “tender” feature, at par. To ensure that the securities are able to be “put” or “tendered” by a holder in the event that a remarketing agent is unable to remarket the security, a VRDO typically operates with a liquidity facility – a Letter of Credit or Standby Bond Purchase Agreement – that ensures that an investor is able to liquidate its position. See Electronic Municipal Market Access, Understanding Variable Rate Demand Obligations, http://emma.msrb.org/EducationCenter/UnderstandingVRDOs.aspx.

A tender option bond is an obligation that grants the bondholder the right to require the issuer or specified third party acting as agent for the issuer (e.g., a tender agent) to purchase the bonds,
analysis of the issuer or obligor’s financial condition, as described above, analysis of the protections for the money market fund provided by the legal structure of the security.67

- For repurchase agreements that are “collateralized fully” under rule 2a-7, an assessment of the creditworthiness of the counterparty, of the volatility and liquidity of the market for collateral, if the collateral is a government agency collateralized mortgage obligation or mortgage backed security, or other non-standardized security, and the process for liquidating collateral.70

- For repurchase agreements that are not fully collateralized under rule 2a-7, a financial analysis and assessment of the minimal credit risk of the counterparty, as described above, without regard to the value of the collateral, and consideration of the type of

usually at par, at a certain time or times prior to maturity or upon the occurrence of specified events or conditions. See Municipal Securities Rulemaking Board, Glossary of Municipal Securities Terms, Tender Option Bond, http://www.msrb.org/glossary/definition/tender-option-bond.aspx. Tender option bonds are synthetically created by a bond dealer or other owner of a long-term municipal obligation purchased in either the primary or secondary markets, or already in a portfolio.

An extendible bond is a long-term debt security with an embedded option for either the investor or the issuer to extend its maturity date. To qualify as an eligible security under rule 2a-7, the issuer must not have the right to extend the maturity of the bond so that it is more than 397 days to maturity at any time. Typically, if an extendible bond is of the type that qualifies as an eligible security under rule 2a-7, a money market fund will have the option to either extend the maturity of the bond to no more than 397 days in the future, or elect not to extend, in which case the bond’s maturity must be no longer than 397 days at that time.

A “step up” security pays an initial interest rate for the first period, and then a higher rate for the following periods.

See OCC Guidance, supra note 56 (OCC credit risk factors for structured securities include evaluation and understanding of specific aspects of the legal structure including loss allocation rules, potential impact of performance and market value triggers, support provided by credit and liquidity enhancements, and adequacy of structural subordination).

Under rule 2a-7(a)(5), for a repurchase agreement to be “collateralized fully,” among other requirements, the collateral must consist entirely of cash items or Government securities. See rule 5b-3(c)(1).

See rule 2a-7(d)(3)(ii)(A) (requiring the fund’s board of directors to evaluate the creditworthiness of the seller of a fully collateralized repurchase agreement when looking to the collateral issued for purposes of determining issuer’s diversification under the rule).

See ICI WORKING GROUP REPORT, supra note 22, at Appendix I (“When repayment of an obligation (such as a repurchase agreement) may depend on the liquidation of securities or other assets (Collateral), the credit analysis should include an assessment of the volatility and liquidity of the market for the Collateral, especially in times of market stress. The analysis also should consider the process for liquidating the Collateral, who would be likely buyers of the Collateral, and how long it might take to complete the liquidation. These factors should be included in the analysis of the Collateral’s potential volatility and liquidity.”).
collateral accepted and the ability of the money market fund to liquidate the collateral.\textsuperscript{71}

This list is not meant to be exhaustive. We recognize that the range and type of specific factors appropriate for consideration could vary depending on the category of issuer and particular security or credit enhancement under consideration, and may include any factors in addition to those discussed above that the board determines appropriate to the credit assessment.\textsuperscript{72} Individual purchases may require more or less analysis depending on the security’s risk characteristics. As discussed in greater detail below, we also would expect that the written record of the minimal credit risk determination generally would address any factors considered and the analysis of those factors.\textsuperscript{73}

We request comment on the factors discussed above for consideration, as appropriate, in the determinations that portfolio securities present minimal credit risk. Do commenters agree that these are relevant factors for advisers to consider in assessing whether portfolio securities present minimal credit risk? Are the factors sufficiently clear? Would it be helpful to describe any of the factors with additional specificity? To what extent do investment advisers currently

\textsuperscript{71} See id.

\textsuperscript{72} See supra text accompanying and following notes 55-70. As noted above, money market fund boards of directors typically delegate minimal credit risk determinations to the fund’s adviser. See supra note 22. Rule 2a-7 requires money market fund boards to establish and periodically review written procedures regarding the delegation (including guidelines for determining whether securities present minimal credit risks) and to take measures reasonably necessary to assure that the guidelines and procedures are being followed. See rule 2a-7(j); see also rule 38a-1 (requiring funds to adopt and implement written policies and procedures reasonably designed to prevent a fund from violating the federal securities laws). These policies and procedures generally should identify the process to be followed by the adviser in performing credit assessments, including, as appropriate, the types of data to be used or factors to be considered with respect to particular securities and the person(s) or position(s) responsible under the delegated authority. They also generally should provide for regular reporting to the board, as appropriate, about these evaluations, to allow the board to provide effective oversight of the process. See 2013 Ratings Removal Adopting Release, supra note 4, at n.50; 1983 Adopting Release, supra note 14, at paragraph preceding paragraph accompanying n.3.

\textsuperscript{73} See infra section II.A.3; proposed rule 2a-7(h)(3).
consider these factors in making minimal credit risk determinations? Do commenters agree with our understanding that consideration of these factors is consistent with current industry practice? Are there factors we should omit or other factors we should consider including, such as credit spreads or the issuer or guarantor’s risk management structure?\textsuperscript{74} If so, why? In light of the amendments being considered in this re-proposal, would the guidance contribute to more consistency in the quality and breadth of money market funds’ credit analyses? If so, would it reduce the potential for significant variations in money market funds’ risk profiles?\textsuperscript{75} Should the factors address other asset classes? If so, what types of securities should be included and what factors would be appropriate for consideration? We do not presently propose to codify the factors as part of rule 2a-7. We request comment, however, on whether codifying these factors would further ensure that funds use objective factors and market data in making credit quality determinations and thereby promote uniformity in making minimal credit risk determinations and/or assist money market fund managers in understanding their obligations pertaining to portfolio quality under rule 2a-7.

2. Conditional Demand Features

Rule 2a-7 limits money market funds to investing in securities with remaining maturities of no more than 397 days.\textsuperscript{76} A long-term security subject to a conditional demand feature\textsuperscript{77}

\textsuperscript{74} These factors have been included in other guidance on making creditworthiness determinations. See 2013 Net Capital Rule Amendments, supra note 51; 1989 Staff Letter, supra note 52; OCC Guidance, supra note 56.

\textsuperscript{75} See Dreyfus Comment Letter, supra note 30.

\textsuperscript{76} See rule 2a-7(a)(12) (defining “eligible security” to mean, among other things, a security with a remaining maturity of 397 calendar days or less).

\textsuperscript{77} A conditional demand feature is a demand feature that a fund may be precluded from exercising because of the occurrence of a condition. See rule 2a-7(a)(6) (defining “conditional demand feature” as a demand feature that is not an unconditional demand feature); rule 2a-7(a)(30) and re-proposed rule 2a-7(a)(25) (defining “unconditional demand feature” as a demand feature that
(“underlying security”), however, may be determined to be an eligible security (or a first tier security) if among other conditions: (i) the conditional demand feature is an eligible security or a first tier security; and (ii) the underlying security (or its guarantee) has received either a short-term rating or a long-term rating, as the case may be, within the highest two categories from the requisite NRSROs or is a comparable unrated security.78 The rule currently requires this analysis of both the short-term and long-term credit aspects of the demand instrument because a security subject to a conditional demand feature combines both short-term and long-term credit risks.79 Our re-proposal would require a similar analysis, but consistent with section 939A of the Dodd-Frank Act would remove the requirement in the rule that the fund board (or its delegate) consider credit ratings of underlying securities.80

by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security). For purposes of rule 2a-7, a demand feature allows the security holder to receive, upon exercise, the approximate amortized cost of the security, plus accrued interest, if any, at the later of the time of exercise or the settlement of the transaction, paid within 397 calendar days of exercise and upon no more than 30 calendar days’ notice. Rule 2a-7(a)(9).

Rule 2a-7(d)(2)(iv). Although underlying securities are generally long-term securities when issued originally, they become short-term securities when the remaining time to maturity is 397 days or less.

The quality of a conditional demand instrument depends both on the ability of the issuer of the underlying security to meet scheduled payments of principal and interest and upon the availability of sufficient liquidity to allow a holder of the instrument to recover the principal amount and accrued interest upon exercise of the demand feature. See Acquisition and Valuation of Certain Portfolio Instruments by Registered Investment Companies, Investment Company Act Release No. 14607 (July 1, 1985) [50 FR 27982 (July 9, 1985)], at n.33. The rule permits the determination of whether a security subject to an unconditional demand feature is an eligible or first tier security to be based solely on whether the unconditional demand feature is an eligible or first tier security because credit and liquidity support will be provided even in the event of default of the underlying security. See rule 2a-7(d)(2)(iii).

In a conforming change, we propose to remove two provisions in current rule 2a-7 that reference credit ratings in connection with securities subject to a demand feature or guarantee of the same issuer that are second tier securities: rule 2a-7(d)(3)(i)(C) (limiting a fund’s investments in securities subject to a demand feature or guarantee of the same issuer that are second tier securities to 2.5% of the fund’s total assets); rule 2a-7(f)(1)(iii) (providing that if, as a result of a downgrade, more than 2.5% of a fund’s total assets are invested in securities issued by or subject
Under our re-proposal, a fund would have to determine, as with any short-term security, that the conditional demand feature is an eligible security.81 In addition, a fund’s board of directors (or its delegate) would have to evaluate the long-term risk of the underlying security and determine that it (or its guarantor) “has a very strong capacity for payment of its financial commitments.”82 This standard is similar to those articulated by credit ratings agencies for long-term securities assigned the second-highest rating.83 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.

to demand features from a single institution that are second tier securities, a fund must reduce its investments in these securities to no more than 2.5% of total assets by exercising the demand feature at the next succeeding exercise date(s). In other conforming changes, we are re-proposing to amend two rules under the Act that reference the definition of “demand feature” and “guarantee” under rule 2a-7, which references would change under our re-proposed amendments. Specifically, we propose to amend: (i) rule 12d3-1(d)(7)(v), to replace the references to “rule 2a-7(a)(8)” and “rule 2a-7(a)(15)” with “§ 270.2a-7(a)(9)” and “§ 270.2a-7(a)(16)”); and (ii) rule 31a-1(b)(1), to replace the phrase “(as defined in § 270.2a-7(a)(8) or § 270.2a-7(a)(15) respectively)” with “(as defined in § 270.2a-7(a)(9) or § 270.2a-7(a)(16) respectively)”.

81 See re-proposed rule 2a-7(d)(2)(iii)(A).

82 Re-proposed rule 2a-7(d)(2)(iii)(C). An underlying security that is a short-term security (because its remaining maturity is less than 397 days, although its original maturity may have been longer) also would have to meet the re-proposed standard.

83 See Fitch Ratings Scales, supra note 38, at 12, 15 (for corporate finance obligations, “‘AA’ ratings denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments;” for structured, project and public finance obligations, “‘AA’ ratings denote expectations of very low default risk. They indicate very strong capacity for payment of financial commitments.”); Moody’s Rating Definitions, supra note 38, at 5 (on the global long-term rating scale, obligations “rated Aa are judged to be of high quality and are subject to very low credit risk.”); and S&P Ratings Definitions, supra note 38, at 3 (“An obligation rated ‘AA’ differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.”).
standard for underlying securities. In making the credit quality determinations required under the re-proposed amendment, a fund adviser could continue to take into account analyses provided by third parties, including ratings provided by ratings agencies, that it considers reliable for such purposes.

The amendments that we are re-proposing to the provisions of rule 2a-7 affecting securities subject to a conditional demand feature are designed to reflect the same standard as the amendment we proposed in 2011. Specifically, in 2011, we proposed to remove the credit rating requirement from the rule 2a-7 provision setting forth the conditions under which a security subject to a conditional demand feature may be determined to be an eligible security and instead require that the fund’s board (or its delegate) determine that the underlying security be of high credit quality and subject to very low credit risk. The re-proposed standard differs in phrasing to more closely parallel the required finding in our re-proposed minimal risk determination. Comments we received on the 2011 proposal all urged us to retain the requirement that a security subject to a demand feature has received at least a second tier rating, to limit the risk that a demand feature might terminate if its underlying security receives a rating below investment grade (i.e., if the underlying security receives a downgrade of two ratings

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84 See Moody’s Rating Definitions, supra note 38, at 5 (long-term obligations “rated A are judged to be upper-medium grade and are subject to low credit risk.”); Fitch Ratings Scales, supra note 38, at 12 (long-term “A ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong.”); S&P Ratings Definitions, supra note 38, at 4 (a long-term obligation “rated ‘A’ is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.”).

85 See supra paragraph following note 45.

86 See 2011 Proposing Release, supra note 4, at section II.A.2.

87 See id. at n.36 and accompanying text.

88 See Schwab Comment Letter, supra note 30 (querying whether different language for proposed descriptions of second tier securities was intended to suggest different standards).
categories under the current rule).\textsuperscript{89}

The re-proposed amendments are consistent with section 939A of the Dodd-Frank Act regarding the removal of ratings. Nevertheless, 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. A downgrade of this type would result in the loss of the demand feature, which would render the security no longer eligible for the portfolio and expose the fund to the increased interest rate risk associated with a long-term security. For this reason, we would retain the current rule 2a-7 requirements that a security subject to a conditional demand feature is an eligible security only if at the time it is acquired, the fund’s board (or the board’s delegate) determines that there is minimal risk that the circumstances that would result in the conditional demand feature terminating will occur, and that either (i) the conditions limiting the demand feature’s exercise can be monitored, or (ii) the fund otherwise receives notice of the occurrence of a limiting condition and the opportunity to exercise the demand feature in accordance with its terms.\textsuperscript{90}

We request comment on our proposed credit quality standard for securities with a conditional demand feature. Do commenters believe that this is an appropriate standard of

\textsuperscript{89} See, e.g., Federated Comment Letter, \textit{supra} note 30; Fidelity Comment Letter, \textit{supra} note 31; ICI Comment Letter, \textit{supra} note 30.

\textsuperscript{90} See re-proposed rule 2a-7(d)(2)(iii)(B) (providing that a security subject to a conditional demand feature is an eligible security only if, at the time of the acquisition of the underlying security, the money market fund’s board of directors has determined that there is minimal risk that the circumstances that would result in the conditional demand feature not being exercisable will occur; and: (i) the conditions limiting exercise either can be monitored readily by the fund or relate to the taxability, under federal, state or local law, of the interest payments on the security; or (ii) the terms of the conditional demand feature require that the fund will receive notice of the occurrence of the condition and the opportunity to exercise the demand feature in accordance with its terms).
creditworthiness? Is it consistent with our goal of retaining a similar degree of risk limitation as in the current rule? Are there alternative standards that would provide a more robust or objective evaluation of credit quality for an underlying security? How should such criteria be applied and/or used? Are there alternative subjective standards that would provide meaningful distinctions among underlying securities? Is our understanding of a fund’s ability to monitor for conditions that would terminate a demand feature correct? How do funds currently satisfy this monitoring condition? Are we correct in our assumption that removing references to ratings in the credit quality requirement for underlying securities is not likely to change fund investment policies significantly?

3. Monitoring Minimal Credit Risks

Rule 2a-7 currently 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 take such action as it determines is in the best interests of the fund and its shareholders.91 In addition, rule 2a-7 requires ongoing review of the minimal credit risks associated with securities for which maturity is determined by reference to a demand feature.92

In 2011, we proposed to amend the rule to require that, in the event the money market fund’s adviser (or any person to whom the board has delegated portfolio management responsibilities) becomes aware of any credible information about a portfolio security or an issuer of a portfolio security that suggests that the security is no longer a first tier security or a second tier security, as the case may be, the board (or its delegate) would have to reassess

91 Rule 2a-7(f)(1)(i)(A). This current reassessment is not required, however, if the downgraded security is disposed of or matures within five business days of the specified event and in the case of certain events (specified in rule 2a-7(f)(1)(i)(B)), the board is subsequently notified of the adviser’s actions. Rule 2a-7(f)(1)(ii).

92 Rule 2a-7(g)(3).
promptly whether the portfolio security continues to present minimal credit risks.93

Most of those who commented on this proposed amendment objected to it.94 They asserted that the proposed standard is too vague and would be burdensome to administer.95 A number of commenters recommended that we instead eliminate the requirement for reassessing minimal credit risk when a security is downgraded by an NRSRO and include a general ongoing obligation to monitor the credit risks of portfolio securities, which would eliminate the need for a separate requirement to identify specific triggers.96

We have carefully considered commenters’ concerns and suggested modifications and have been persuaded to re-propose a different standard. In order to meet the requirements of section 939A of the Dodd-Frank Act, we re-propose to eliminate the requirement that a fund reassess credit risks of an issuer when a security is downgraded by an NRSRO.97 In consideration of our re-proposed standard for credit quality, and consistent with the approach suggested by a number of commenters, we instead re-propose to require that each money market fund adopt written procedures that require the fund adviser to provide ongoing review of the credit quality of each portfolio security (including any guarantee or demand feature on which the fund relies to determine portfolio quality, maturity, or liquidity) to determine that the security

See 2011 Proposing Release, supra note 4, at section II.A.3.

But see Comment Letter of CFA Institute (July 13, 2011) (supporting the proposed monitoring standard).

See, e.g., ICI Comment Letter, supra note 30 (there are numerous sources of information about issuers, much of which is not relevant to the issuer’s ability to meet its short-term obligations); Invesco Comment Letter, supra note 30 (the ambiguity in the terms “credible information” and “suggest” will complicate enforcement of the rule); Schwab Comment Letter, supra note 30 (the word “suggests” is not constrained by a reasonableness or likelihood standard).

See, e.g., Federated Comment Letter, supra note 30; ICI Comment Letter, supra note 30; T. Rowe Price Comment Letter, supra note 30.

See rule 2a-7(f)(1).
continues to present minimal credit risks.\(^9\) 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.\(^9\) 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.\(^10\) We note that funds could continue to consider external factors, including credit ratings, as part of the ongoing monitoring process.\(^10\)

Although rule 2a-7 does not explicitly require ongoing monitoring of whether a security

\(^9\) Re-proposed rule 2a-7(g)(3). Our re-proposal would remove current rule 2a-7(f)(1)(i) (downgrades and rating below second tier previously unrated securities) and 2a-7(g)(3) (securities for which maturity is determined by reference to demand features). Re-proposed rule 2a-7 includes a new paragraph (g)(3), which would contain the required procedures for the ongoing review of credit risks.

\(^10\) See re-proposed rule 2a-7(g)(3)(ii). Currently, when a security’s maturity is determined by reference to a demand feature, the board’s review of the security’s minimal credit risks must be based on, among other things, financial data for the most recent fiscal year of the issuer of a demand feature. See rule 2a-7(g)(3). A fund also should review any other factors considered as part of its initial minimal credit risk determination.
presents minimal credit risks, as a practical matter, we believe most fund advisers currently engage in similar types of ongoing monitoring because (i) funds regularly “roll over” positions in portfolio securities, which triggers the obligation to make a new minimal credit risk determination (ii) rule 2a-7 requires funds to reassess whether a security presents minimal credit risks upon the occurrence of certain events (iii) events such as downgrades can result in a decrease in the mark-to-market value of the fund portfolio, threatening the ability of the fund to maintain a stable net asset value (iv) changes in credit ratings of a fund’s portfolio securities may threaten the fund’s own ability to maintain a rating from an NRSRO and (v) shareholders may be more likely to redeem if the credit quality of portfolio securities declines. We do not believe that the re-proposal for an explicit monitoring requirement would significantly change

Funds must limit their portfolios to securities that, among other requirements, are eligible securities at the time of acquisition, which is defined to mean any purchase or subsequent rollover. Rules 2a-7(a)(1); 2a-7(d)(2).

Rule 2a-7(f)(1) (requiring a money market fund’s board of directors to reassess promptly whether a security continues to present minimal credit risks if (i) a first tier portfolio security has been downgraded (or an unrated security is no longer of comparable quality to a first tier security), and (ii) the fund adviser becomes aware that any unrated security or second tier security has been given a rating below a second tier rating).

See rule 2a-7(g)(1).


current fund practices in monitoring minimal credit risks in the portfolio. Moreover, we do not believe that the re-proposal to remove the credit reassessment requirement in the event of a downgrade would result in less diligence on the part of money market fund managers because, as discussed above, a decline in the quality of a fund’s portfolio securities could affect a fund’s own NRSRO rating and could increase shareholder redemptions.

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\(^{107}\) 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 generally should establish procedures for the adviser to notify the board in such circumstances.\(^{108}\)

For the reasons discussed above, we believe this re-proposed requirement to monitor credit risk would essentially codify the current practices of fund managers, which are already explicit (and implicit) in several provisions of the rule discussed above. Our re-proposal to explicitly require that funds perform ongoing monitoring of credit risks is designed to ensure that funds are better positioned to quickly identify potential risks of credit events that could impact portfolio security prices and ultimately, for certain funds, the ability of the fund to maintain its

\(^{107}\) We use the term “relevant credit rating agencies” to mean those NRSROs whose downgrades would likely affect the value of a portfolio security.

\(^{108}\) See rule 2a-7(j)(2); rule 2a-7(g)(1) (requiring that for funds using amortized cost, the board, as part of its overall duty of care owed to its shareholders, adopt written procedures reasonably designed, taking into account current market conditions and the money market fund’s investment objectives, to maintain a stable net asset value per share).
stable net asset value.\textsuperscript{109}

We request comment on the re-proposed monitoring requirement. Is our understanding of how funds currently monitor fund portfolio securities correct? If not, how are fund practices different? Would our proposed amendments, if adopted, impose additional or different costs on funds or their advisers, and if so, what would these costs be? Should the rule include specific objective events that would require a reevaluation of minimal credit risks? Would an explicit monitoring requirement change current fund priorities in monitoring minimal credit risks in the portfolio? Would the re-proposal assist funds to better position themselves to quickly identify potential risks of credit events that could impact portfolio security prices? Would replacing the credit reassessment requirement in the event of a downgrade with a requirement for ongoing monitoring result in less or more diligence on the part of money market fund managers? As a practical matter, would a fund adviser’s obligation to monitor risks to which the fund is exposed likely require the adviser to monitor for downgrades by relevant credit ratings agencies, as well as monitor, for each portfolio security, each NRSRO rating considered as part of the minimal credit risk determination at the time the security was acquired? Are there any alternatives to the

\textsuperscript{109} As under the current rule, the process undertaken by the fund’s board (or adviser) for establishing credit quality and the records documenting that process would be subject to review in regulatory examinations by Commission staff. See Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934, Securities Exchange Act Release No. 64352 (Apr. 27, 2011) [76 FR 26550 (May 6, 2011)], at text following n.30. 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. See id. See also Ambassador Capital Management LLC, et al., Investment Company Act Release No. 30809 (Nov. 26, 2013) (alleging that money market fund adviser’s failure to (i) make and retain a written record of its minimal credit risk determinations resulted in the fund’s violation of rule 22c-1 and (ii) follow the fund’s compliance procedures regarding the determination of minimal credit risk and the maintenance of records of the determination resulted in the fund’s violations of rule 38a-1).
re-proposed monitoring requirement that would permit funds to monitor minimal credit risks more effectively, or that would better reflect funds’ current monitoring practices, than the re-proposed requirement?

4. Stress Testing

Money market funds currently must adopt written procedures for stress testing their portfolios and perform stress tests according to these procedures on a periodic basis. Specifically, a fund must test its ability based on certain hypothetical events, including a downgrade of particular portfolio security positions, to: (i) have invested at least 10 percent of its total assets in weekly liquid assets; and (ii) minimize principal volatility (and, in the case of a money market fund using the amortized cost method of valuation or penny rounding method of pricing, the fund’s ability to maintain a stable share price per share). In 2011, we proposed to replace this reference to ratings downgrades with the requirement that money market funds stress test their portfolios for an adverse change in the ability of a portfolio security issuer to meet its short-term credit obligations.

Commenters on the 2011 proposal who addressed this issue uniformly advocated against eliminating the reference to a downgrade in the stress testing conditions. They argued that the Dodd-Frank Act does not prohibit regulations, such as this stress testing provision, that refer to credit ratings without requiring an assessment of a security’s creditworthiness.

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110 See rule 2a-7(g)(8).

111 See rule 2a-7(g)(8)(i) (requiring written procedures providing for periodic stress testing in light of various events, including a “downgrade or default of particular portfolio security positions, each representing various portions of the fund’s portfolio (with varying assumptions about the resulting loss in the value of the security), in combination with various levels of an increase in shareholder redemptions”); 2014 Money Market Fund Adopting Release, supra note 8, at section III.J.


113 See, e.g., Dreyfus Comment Letter, supra note 30; ICI Comment Letter, supra note 30.
In consideration of the comments we received and the mandate in section 939A of the Dodd-Frank Act, we re-propose to replace the reference to ratings downgrades in the stress testing requirement with a hypothetical event that is designed to have a similar impact on a money market fund’s portfolio. Our re-proposed stress testing amendments would require that money market funds stress test for an event indicating or evidencing credit deterioration of particular portfolio security positions, each representing various exposures in a fund’s portfolio.\footnote{Re-proposed rule 2a-7(g)(8)(i)(B) (the re-proposal would require stress testing for an event indicating or evidencing the credit deterioration, such as a downgrade or default, of a portfolio security position representing various portions of the fund’s portfolio (with varying assumptions about the resulting loss in the value of the security), in combination with various levels of an increase in shareholder redemptions).} The re-proposed amendments would describe the type of hypothetical event that funds should use for testing and include a downgrade or default as examples of that type of event. Thus, funds could continue to test their portfolios against a potential downgrade or default in addition to any other indication or evidence of credit deterioration they determine appropriate (and that might adversely affect the value or liquidity of a portfolio security).

We note that the 2013 Money Market Fund Reform Proposing Release requested comment on certain aspects of money market fund stress testing as it relates to our obligation under section 165(i)(2) of the Dodd-Frank Act to specify certain stress testing requirements for nonbank financial companies\footnote{For a definition of “nonbank financial companies” for these purposes, see Definition of “Predominantly Engaged in Financial Activities” and “Significant” Nonbank Financial Company and Bank Holding Company, Board of Governors of the Federal Reserve System [78 FR 20756 (Apr. 5, 2013)].} that have total consolidated assets of more than $10 billion and are regulated by a primary federal financial regulatory agency.\footnote{See 2013 Money Market Fund Proposing Release, supra note 5, at section III.L.} As discussed in that release and the 2014 Money Market Fund Adopting Release, we intend to engage in a separate
rulemaking to implement the requirements to section 165(i) of the Dodd-Frank Act.\textsuperscript{117} We request comment on our re-proposed amendment to the stress testing requirements. Should the rule require testing against specifically named events rather than an event the fund chooses that indicates or evidences credit deterioration? Does the re-proposed hypothetical event provide adequate guidance to funds? Is there a different hypothetical event, other than a downgrade, that we should specify?

B. Form N-MFP

As part of the money market fund reforms adopted in 2010, money market funds must provide to the Commission a monthly electronic filing of portfolio holdings information on Form N-MFP.\textsuperscript{118} The information that money market funds must disclose with respect to each portfolio security (and any guarantee, demand feature, or other enhancement associated with the portfolio security) includes the name of each designated NRSRO for the portfolio security and the rating assigned to the security.\textsuperscript{119}

In 2011, we proposed to eliminate the form items that currently require a fund to identify whether a portfolio security is a first tier or second tier security or is an unrated security, and that require the fund to identify the “requisite NRSROs” for each security (and for each demand feature, guarantee or other credit enhancement). Several commenters strongly objected to

\textsuperscript{117} See id. at section III.L; 2014 Money Market Fund Adopting Release, supra note 8, at section III.J.5.

\textsuperscript{118} See rule 30b1-7; see also 2010 Money Market Fund Adopting Release, supra note 41, at n.301 and accompanying and preceding text.

\textsuperscript{119} See Form N-MFP Items 34 (requiring disclosure of each designated NRSRO for a portfolio security and the credit rating given by the designated NRSRO for each portfolio security); 37b-c (requiring disclosure of each designated NRSRO and the credit rating given by the designated NRSRO for each portfolio security demand feature); 38b-c (requiring disclosure of each designated NRSRO and the credit rating given by the designated NRSRO for each portfolio security guarantee); and 39c-d (requiring disclosure of each designated NRSRO and the credit rating given by the designated NRSRO for each portfolio security enhancement).
removing ratings disclosures in Form N-MFP. They argued that the Dodd-Frank Act does not require us to eliminate these disclosures because these references to ratings do not require the use of an assessment of creditworthiness.\textsuperscript{120} We have carefully considered these comments and are re-proposing instead to require that each money market fund disclose, for each portfolio security, (i) each rating assigned by any NRSRO if the fund or its adviser subscribes to that NRSRO’s services, as well as the name of the agency providing the rating, and (ii) any other NRSRO rating that the fund’s board of directors (or its delegate) considered in making its minimal credit risk determination, as well as the name of the agency providing the rating.\textsuperscript{121} The first prong of this requirement reflects our assumption that a fund manager subscribes to the services of a particular NRSRO because the manager has confidence in that NRSRO’s analysis and, therefore, when assessing the credit quality of a portfolio security, would consider any rating the NRSRO assigns to the security. If a fund’s adviser has considered more than one NRSRO rating in making a minimal credit risk determination for a particular portfolio security, the Form N-MFP disclosure would need to reflect each rating considered (in addition to each rating assigned by an NRSRO if the fund or its adviser subscribes to its services). If the fund and its adviser subscribe to no NRSRO ratings services, and no other rating was considered in making a minimal credit risk determination, the fund would disclose no rating for the portfolio security. We believe this information on ratings may be useful both to the Commission and to investors to monitor credit ratings that funds use in evaluating the credit quality of portfolio securities and to evaluate risks

\textsuperscript{120} See, e.g., Federated Comment Letter, \textit{supra} note 30; Dreyfus Comment Letter, \textit{supra} note 30.

\textsuperscript{121} See re-proposed Form N-MFP Item C.10. In a conforming change, the re-proposal would also amend Form N-MFP Item C.9 to require disclosure of whether the portfolio security is an eligible security.
that fund managers take.122 Disclosures of individual portfolio securities ratings would provide
investors, Commission staff, and others with a snapshot of potential trends in a fund’s overall
risk profile, which could in turn prompt those monitoring to research or evaluate further whether
that profile is changing.

We seek comment on the re-proposed disclosures relating to credit ratings in Form
N-MFP. Are we correct in our assumption that as part of its minimal credit risk determination a
fund manager would consider each rating assigned to a portfolio security by an NRSRO to
whose services the fund or the manager subscribes? Would the proposed disclosures assist
investors in monitoring credit risks in money market fund portfolios? Would the disclosures be
more useful if they required funds that consider any rating to disclose the highest and lowest
rating assigned to the portfolio security, regardless of whether the fund considered that rating?
Should fund managers that consider more than one credit rating in their credit evaluations be
required to disclose only one rating and its source? Would disclosure of only one rating limit an
investor’s ability to monitor the fund’s credit risk if another rating assigned to a portfolio
security differs from the rating disclosed by the fund in Form N-MFP (i.e., the security is split-
rated)? Under such an approach, if a portfolio security is split-rated, which rating should the
fund have to disclose, or should a fund be able to choose the rating it discloses? If a fund could
choose, would any funds disclose a lower rating assigned by an NRSRO? We took a similar
approach in recent amendments removing the required use of credit ratings in Forms N-1A, N-2
and N-3. Under those amendments, funds that choose to use credit quality to present their
portfolio securities in shareholder reports and use credit ratings to depict credit quality may use

122 See Comment Letter of BlackRock, Inc. (Apr. 25, 2011) (“BlackRock Comment Letter”) (“this
disclosure facilitates investors’ ability to evaluate [money market fund] portfolios and to compare
[money market funds] to each other.”).
credit ratings assigned by different rating agencies (including credit rating agencies that are not NRSROs), provided that the fund also describes how it determines the credit quality of portfolio holdings and how ratings are identified and selected. Would a similar disclosure describing how a money market fund determines the credit quality of portfolio holdings, including how ratings are identified and selected be appropriate considering the format of Form N-MFP? If not, would disclosure in another form, such as Form N-1A, appropriately mitigate the risk that a fund could “cherry-pick” the rating to disclose on Form N-MFP? Would investors find disclosure about the source of the credit rating to be useful information?

C. Exclusion from the Issuer Diversification Requirement

In addition to the provisions regarding credit quality discussed above, rule 2a-7’s risk limiting conditions require a money market fund’s portfolio to be diversified, both as to the issuers of the securities it acquires and providers of guarantees and demand features related to those securities. Generally, money market funds must limit their investments in the securities of any one issuer of a first tier security (other than government securities) to no more than 5 percent of total assets. They must also generally limit their investments in securities subject

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123 Form N-1A Item 27(d); Form N-2 Item 24, Instruction 6(a); Form N-3 Item 28(a), Instruction 6(i); see also 2013 Ratings Removal Adopting Release, supra note 4, at section III.B.

124 See rule 2a-7(d)(3). The diversification requirements of rule 2a-7 differ in significant respects from the requirements for diversified management investment companies under section 5(b)(1) of the Investment Company Act. A money market fund that satisfies the applicable diversification requirements of paragraph (d)(3) of rule 2a-7 is deemed to have satisfied the requirements of section 5(b)(1). Rule 2a-7(d)(3)(v). Subchapter M of the Internal Revenue Code contains other diversification requirements for a money market fund to be a “regulated investment company” for federal income tax purposes. 26 U.S.C. 851 et seq.

125 Rule 2a-7(d)(3)(i)(A) and (B). A single state fund, however, may invest up to 25% of its total assets in the first tier securities of any single issuer. Rule 2a-7(d)(3)(i)(B). A fund also may invest no more than 0.5% of fund assets in any one issuer of a second tier security. Rule 2a-7(d)(3)(i)(C). The rule provides a safe harbor under which a taxable and national tax-exempt fund may invest up to 25% of its total assets in the first tier securities of a single issuer for a
to a demand feature or a guarantee to no more than 10 percent of total assets from any one provider.\textsuperscript{126} We adopted these requirements in order to limit the exposure of a money market fund to any one issuer, guarantor, or demand feature provider.\textsuperscript{127}

By permitting money market funds a higher 10 percent limit on their indirect exposures to a single provider of a guarantee or demand feature than the 5 percent limit on direct investments in any one issuer, rule 2a-7 permits a money market fund to take on greater indirect exposures to providers of demand features and guarantees. That is because, rather than looking solely to the issuer, the money market fund would have two potential sources of repayment—the issuer whose securities are subject to the demand features or guarantees and the providers of those features or guarantees if the issuer defaults. Both the issuer and the demand feature provider or guarantor would have to default at the same time for the money market fund to suffer a loss. And if a guarantor or demand feature provider were to come under stress, the issuer may

\textsuperscript{126} Rule 2a-7 also provides a “fifteen percent basket” for tax-exempt (including single-state) money market funds, under which as much as 15\% of the value of securities held in a tax-exempt fund’s portfolio may be subject to guarantees or demand features from a single institution. \textit{See rule 2a-7(d)(3)(iii)(B)}. The tax-exempt fund, however, may only use the 15\% basket to invest in demand features or guarantees issued by non-controlled persons that are first tier securities. \textit{See rule 2a-7(c)(4)(iii)(B) and (C)}. Under our re-proposal, the 15\% basket would be available with respect to any demand feature or guarantee issued by a non-controlled person without regard to the rating of the security, guarantee or demand feature. \textit{See supra} note 36.

be able to obtain a replacement.128

Today, we adopted amendments to certain provisions of these diversification requirements in the 2014 Money Market Fund Adopting Release.129 Among other things, our amendments require that money market funds treat certain entities that are affiliated with each other as single issuers when applying the 5 percent issuer diversification provision of rule 2a-7 and treat the sponsors of asset-backed securities as guarantors subject to the 10 percent diversification provision of rule 2a-7 applicable to guarantees and demand features, unless the fund’s board makes certain findings. These amendments were intended to increase the resiliency of and reduce risk in money market funds by limiting their ability to concentrate investments in a single economic enterprise.

When we proposed these amendments, we also discussed and sought comment on additional alternatives that we had considered to appropriately limit money market funds’ risk exposure.130 These alternatives included requiring money market funds to be more diversified by reducing the current 5 percent and 10 percent diversification thresholds of rule 2a-7 and by imposing industry concentration limits. Several commenters supported some of these tighter diversification requirements.131 One of these commenters suggested limiting any one corporate issuer to 2.5 percent of the fund’s total assets rather than the current 5 percent issuer

128 See, e.g., Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No.19959 (Dec. 17, 1993) [58 FR 68585 (Dec. 28, 1993)] at n.83 and accompanying text (observing that, if the guarantor of one of the money market fund’s securities comes under stress, “issuers or investors generally can either put the instrument back on short notice or persuade the issuer to obtain a substitute for the downgraded institution”).


diversification requirement, while two others supported additional sector diversification requirements. Others, however, argued against further narrowing the diversification provisions of rule 2a-7 relating to issuers and guarantors.

We also asked in the 2013 Money Market Fund Proposing Release more generally whether we should continue to distinguish between a fund’s exposure to guarantors and issuers by providing different diversification requirements for these exposures. We explained that rule 2a-7 permits a money market fund, when determining if a security subject to a guarantee satisfies the credit quality standards, to rely exclusively on the credit quality of the guarantor. We specifically asked whether the guarantor should be treated as the issuer and subject to a 5 percent diversification requirement whenever the money market fund is relying exclusively on the credit quality of the guarantor. No commenters specifically addressed this issue, and we decided not to propose amendments that would implement this approach, or any of the alternative diversification approaches about which we sought comment as discussed above.

In considering the comments we received on the proposed amendments to the

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132 See J. Barber Comment Letter, supra note 131 (recommending 2.5% issuer limit); R. Comment Comment Letter, supra note 131 (advocating sector diversification); Boston Federal Reserve Comment Letter, supra note 131 (same).

133 Comment Letter of Phillip S. Gillespie, Executive Vice President and General Counsel, State Street Global Advisors (Sept. 17, 2013) (opposing the additional alternatives because existing diversification limits are already challenging due to the short-term market’s current supply structure); Comment Letter of Investment Company Institute (Sept. 17, 2013) (“ICI 2013 Comment Letter”). One of these expressed concern that further restricting diversification limits may potentially force money market funds to invest in less creditworthy issuers, which could have the effect of increasing the risk within money market funds’ portfolios, rather than decreasing it. See id.


135 Rule 2a-7(d)(2)(iii). That a money market fund has both the issuer and guarantor as sources of repayment may not meaningfully reduce the risks of the investment in all cases because the issuer of the guaranteed securities need not satisfy rule 2a-7’s credit quality requirements, and if the issuer of the guaranteed securities is of lesser credit quality, allowing the money market fund to have up to 10% of its assets indirectly exposed to the guarantor may not be justified.
diversification provisions and the alternatives discussed above, we noted that money market funds also may effectively rely exclusively on the credit quality of certain guarantors for purposes of the diversification requirements. Notwithstanding the 5 percent issuer diversification provision, rule 2a-7 does not require a money market fund to be diversified with respect to issuers of securities that are subject to a guarantee by a non-controlled person.\textsuperscript{136} This exclusion could allow, for example, a fund to invest a significant portion or all of the value of its portfolio in securities issued by the same entity if the securities were guaranteed by different non-controlled person guarantors such that none guaranteed securities with a value exceeding 10 percent of the fund’s total assets. By diversifying solely against the guarantor, the fund could be relying on the guarantors’ credit quality or repayment ability, not the issuer’s. Thus, the fund would effectively substitute the credit of the guarantor for that of the issuer for diversification purposes, without imposing the tighter 5 percent requirement that rule 2a-7 generally applies for issuer diversification. The fund also would have a highly concentrated portfolio and would be subject to substantial risk if the single issuer in whose securities it had such a significant investment were to come under stress or default.

We are concerned that a money market fund relying on the exclusion from the issuer diversification provision need only comply with the 10 percent guarantor diversification requirement, notwithstanding the credit substitution discussed above. In consideration of our reform goal of limiting concentrated exposure of money market funds to particular economic enterprises, we no longer believe that ignoring a fund’s exposure to the issuer in these

\textsuperscript{136} Rule 2a-7(d)(3)(i). A guarantee issued by a non-controlled person means a guarantee issued by: (i) a person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the guarantee; or (ii) a sponsor of a special purpose entity with respect to an asset-backed security. Rule 2a-7(a)(19). Control has the same meaning as in section 2(a)(9) of the Investment Company Act, 15 U.S.C. 80a-2(a)(9).
circumstances is appropriate. Rather than subject these guarantors to a unique 5 percent requirement, however, we believe that a better approach would be to restrict risk exposures to all issuers of securities subject to a guarantee or demand feature under rule 2a-7 in the same way. That is, under today’s proposed amendment, each money market fund that invests in securities subject to a guarantee (whether or not the guarantor is a non-controlled person) would have to comply with both the 10 percent diversification requirement for the guarantor as well as the 5 percent diversification requirement for the issuer. As a result, except for the special provisions regarding single-state money market funds, no money market fund non-government portfolio security would be excluded from rule 2a-7’s limits on issuer concentration.

We recognize that the proposed removal of this exclusion and tightening of issuer diversification requirements for securities subject to a guarantee by a non-controlled person could impact issuers of these securities and the fund’s risk profile (although we note that fewer than 2 percent of money market funds appear to be relying on this exclusion). The proposed amendments could occasionally prevent some issuers from selling securities to a money market fund that would otherwise invest in the issuer’s securities above the 5 percent diversification requirement. In addition, while we recognize that removing the exclusion could cause some money market funds to invest in securities with higher credit risk, we note that a money market fund

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137 See 2014 Money Market Fund Adopting Release, supra note 8, at text following n.1600 and accompanying n.1601. The exclusion from the 5% issuer diversification requirement for certain guaranteed securities was adopted in the 1996 money market fund amendments to provide flexibility in municipal investments, and was premised on the ability of a money market fund to rely on the guarantee if an issuer became distressed. See 1996 Money Market Fund Adopting Release, supra note 62. Since 1996, our amendments have generally scaled back on the amount of additional flexibility focused on the municipal markets, particularly where money market funds do not heavily rely on the exclusion. See, e.g., 2010 Money Market Fund Adopting Release, supra note 41.

138 See infra section V.C.2.
fund’s portfolio securities must meet certain credit quality requirements, such as posing minimal credit risks, as discussed above.\textsuperscript{139} We therefore believe that the substantial risk limiting provisions of rule 2a-7 would mitigate the potential that these money market funds would significantly increase their investments in securities with higher credit risk. We also believe that eliminating this exclusion would more appropriately limit money market fund risk exposures by limiting the concentration of exposure that a money market fund could have otherwise had to a particular issuer.\textsuperscript{140}

We request comment on our proposal to eliminate the exclusion from the issuer diversification requirement. Do commenters agree with our approach to treat securities subject to a guarantee by a non-controlled person similar to other securities with a guarantee or demand feature under rule 2a-7? Should we instead, as discussed above, require that a guarantor be treated as the issuer and subject to a 5 percent diversification requirement when a money market fund is relying exclusively on the credit quality of the guarantor or when the security need not meet the issuer diversification requirements? Or should we impose a higher limit on issuer exposure when the security is guaranteed by a non-controlled person? If so, what would be an appropriate limit? For example, would a 10 percent, 15 percent, or some other limit be appropriate? What limit would appropriately balance the interests discussed above – allowing greater flexibility for funds with respect to indirect exposures to providers of guarantees and demand features because of the potential that tighter diversification provisions could lead to investments in lower quality securities and limiting exposure risk when a fund is relying solely on such a provider for repayment? Could commenters provide empirical analysis to support a

\textsuperscript{139} See rule 2a-7(d)(2) (portfolio quality); supra notes 20-24 and accompanying text.

\textsuperscript{140} See infra section V.C.2.
particular percentage? Do commenters agree with our understanding that most money market funds do not currently rely on the issuer diversification exclusion for securities subject to a guarantee issued by a non-controlled person? Do commenters believe that many money market funds have used this exclusion in the past or may do so in the future absent our proposed amendment? We note that most of the funds whose portfolios have greater than 5 percent exposure to an issuer are tax-exempt funds, and that most of these funds exceed the 5 percent threshold by less than 2 percent of fund assets. In addition, none of the funds that appear to have relied on the exclusion is a single state fund. As a result, we have assumed that tax-exempt funds do not need this exclusion. Is this assumption correct? Is the supply of high quality eligible municipal investments sufficiently limited such that we should preserve the exclusion for tax-exempt or single state funds? Are there any other particular types of funds for which the current exclusion from the issuer diversification requirement should be preserved? Is the proposed amendment likely to result in money market funds investing in securities that present higher credit risk, or not, given the credit quality requirements of rule 2a-7?

III. COMPLIANCE PERIOD FOR THE PROPOSED RULE AND FORM AMENDMENTS

We anticipate that the compliance date for the re-proposed amendments to rule 2a-7 and Form N-MFP and the proposed amendments to the issuer diversification requirements would be [INSERT DATE 18 MONTHS AFTER JULY 2014 MONEY MARKET FUND RULES’ EFFECTIVE DATE]. We expect that this compliance date should provide an adequate period of time for money market funds to review and revise their policies and procedures for complying with rule 2a-7, as funds deem appropriate in connection with the re-proposed and proposed

141 As noted above, rule 2a-7 currently permits a single state fund to invest up to 25% of its assets in any single issuer, thus these funds appear not to need the exclusion. See supra note 125.
amendments, if adopted.\textsuperscript{142} We note that this compliance date would coincide with the compliance date for the rule 2a-7 amendments relating to diversification and stress testing adopted in the 2014 Money Market Fund Adopting Release, as well as the Form N-MFP amendments also adopted in that release. As discussed below, we believe that coordinating the compliance date of the re-proposed amendments with the compliance date of certain related amendments adopted in the 2014 Money Market Fund Adopting Release should reduce costs to the extent feasible by consolidating changes to be made to a fund’s policies and procedures, as well as changes to Form N-MFP, at a single time.\textsuperscript{143} We request comment on this compliance date.

IV. \textbf{PAPERWORK REDUCTION ACT ANALYSIS}

Certain provisions of our proposal contain “collections of information” within the meaning of the Paperwork Reduction Act of 1995 ("PRA").\textsuperscript{144} The titles for the existing collections of information are: (1) “Rule 2a-7 under the Investment Company Act of 1940, Money market funds” (OMB Control No. 3235-0268); (2) “Rule 30b1-7 under the Investment Company Act of 1940, Monthly report for money market funds” (OMB Control No. 3235-0657); and (3) “Form N-MFP under the Investment Company Act of 1940, Monthly schedule of portfolio holdings of money market funds” (OMB Control No. 3235-0657). The Commission is submitting these collections of information to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

\textsuperscript{142} See infra note 219 and accompanying text.
\textsuperscript{143} See infra note 233 and accompanying text.
\textsuperscript{144} 44 U.S.C. 3501-3520.
The agency has submitted the proposed collections of information to OMB for approval. Comments on the proposed collections of information should be directed to: (i) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10102, New Executive Office Building, Washington, D.C. 20503, or by sending an e-mail to: Shagufta_Ahmed@omb.eop.gov; and (ii) Thomas Bayer, Chief Information Officer, Securities and Exchange Commission, c/o Remi Pavlik-Simon, 6432 General Green Way, Alexandria, VA 22312 or send an email to: PRA_Mailbox@sec.gov. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this Release; therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this Release. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-07-11, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE, Washington, DC 20549-2736.

A. **Rule 2a-7**

As discussed above, we are re-proposing to remove references to credit ratings in rule 2a-7, which would affect five elements of the rule: (i) determination of whether a security is an eligible security; (ii) determination of whether a security is a first tier security; (iii) credit quality standards for securities with a conditional demand feature; (iv) requirements for monitoring securities for ratings downgrades and other credit events; and (v) stress testing. These amendments involve collections of information, and the respondents to the collections of information are money market funds. This collection of information would be mandatory for money market funds that rely on rule 2a-7, and to the extent that the Commission receives confidential information pursuant to the collection of information, such information will be kept
Eligible Security Determinations for Money Market Fund Portfolio Securities, Including Securities That Are Subject to a Conditional Demand Feature

Rule 2a-7 limits a money market fund’s portfolio investments to “eligible securities,” which are currently defined as securities that have received credit ratings from a requisite NRSRO in one of the two highest short-term rating categories, or comparable unrated securities. The rule also restricts money market fund investments to securities that the fund’s board, or its delegate, determines present minimal credit risks, and requires a fund to adopt policies and procedures regarding minimal credit risk determinations. As discussed above, we are re-proposing amendments to rule 2a-7 that would remove any reference to, or requirement of reliance on, credit ratings in rule 2a-7 and modify the credit quality standard to be used in determining the eligibility of a money market fund’s portfolio securities, including securities that are subject to a conditional demand feature. Specifically, the re-proposed amendments would eliminate the current requirement that an eligible security be rated in one of the two highest short-term rating categories by an NRSRO or be of comparable quality, and would combine the current “first tier” and “second tier” credit risk categories into a single standard, which would be included as part of rule 2a-7’s definition of eligible security. A security would be an eligible security only if the money market fund’s board of directors (or its delegate) determines that it

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145 See, e.g., 5 U.S.C. 552 (Exemption 4 of the Freedom of Information Act provides an exemption for “trade secrets and commercial or financial information obtained from a person and privileged or confidential.” 5 U.S.C. 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are “contained in or related to examination, operating, or condition reports prepared by, or on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions.” 5 U.S.C. 552(b)(8)).

146 See rule 2a-7(a)(12).

147 See rules 2a-7(d)(2)(i); 2a-7(j)(1); 38a-1.
presents minimal credit risks, which determination would include a finding that the security’s issuer has an exceptionally strong capacity to meet its short-term obligations.\textsuperscript{148} The re-proposed amendments also would require that, with respect to a security (or its guarantee) subject to a conditional demand feature, the underlying security (or its guarantee) must have a very strong capacity for payment of its financial commitments.\textsuperscript{149}

Money market funds are required to have written policies and procedures regarding minimal credit risk determinations.\textsuperscript{150} Thus, each money market fund complex would incur one-time costs to comply with these re-proposed amendments, if adopted. Specifically, each fund complex would incur costs to review the amended provisions of rule 2a-7 and, as it determines appropriate in light of the re-proposed amendments, revise its policies and procedures to incorporate the amended credit quality standards to be used in determining the eligibility of a money market fund’s portfolio securities, including securities that are subject to a conditional demand feature. As discussed below, we anticipate that many funds are likely to retain their investment policies as currently required under rule 2a-7, which incorporate NRSRO ratings and which would be permitted under the re-proposed rule amendments.\textsuperscript{151} Some funds, on the other hand, may choose to revise their investment policies to remove references to NRSRO ratings and to incorporate the standards provided in the re-proposal, if adopted. Even if funds choose to eliminate references to ratings in their investment policies, funds’ investment policies may not change substantially, as funds are already required to assess credit quality apart from ratings as

\textsuperscript{148} Re-proposed rule 2a-7(a)(11); see supra section II.A.1.

\textsuperscript{149} Re-proposed rule 2a-7(d)(2)(ii)(C); see supra section II.A.2.

\textsuperscript{150} See rule 2a-7(j)(1); supra note 22.

\textsuperscript{151} See infra note 204 and accompanying paragraph.
part of their minimal credit risk determinations. In addition to revisions concerning NRSRO ratings, some funds may choose to revise their policies and procedures to address certain factors discussed above (to the extent those factors are not considered currently) in their credit assessment policies and procedures.

While we cannot predict with precision the extent to which funds may revise their policies and procedures for determining minimal credit risk, we estimate that each money market fund complex on average would incur a one-time burden of 9 hours, at a cost of $2,838, to review and revise, as appropriate, its policies and procedures. Using an estimate of 84 money market fund complexes, we estimate that money market funds would incur, in aggregate, a total one-time burden of 756 hours, at a cost of $238,392, to comply with the amended provisions of rule 2a-7 modifying the credit quality standard to be used in determining the

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152 See rule 2a-7(d)(2)(i).

153 We estimate that the lower range of the one-time hour burden for a money market fund complex to review and revise, as appropriate, its policies and procedures for determining minimal credit risk would be 6 hours (4 hours by a compliance manager, and 2 hours by an attorney). We estimate that the upper range of the one-time hour burden for a money market fund complex to review and revise, as appropriate, its policies and procedures for determining minimal credit risk would be 12 hours (8 hours by a compliance manager, and 4 hours by an attorney). For purposes of our estimates for the PRA analysis, we have taken the mid-point of this range (mid-point of 6 hours and 12 hours = 9 hours (6 hours by a compliance manager, and 3 hours by an attorney)).

154 This estimate is based on the following calculation: (6 hours (mid-point of 4 hours and 8 hours incurred by a compliance manager) x $283 (rate for a compliance manager) = $1,698) + (3 hours (mid-point of 2 hours and 4 hours incurred by an attorney) x $380 (rate for an attorney) = $1,140) = $2,838. All estimated wage figures discussed here and throughout this Release are based on published rates that have been taken from SIFMA’s Management & Professional Earnings in the Securities Industry 2013, available at http://www.sifma.org/research/item.aspx?id=8589940603, modified by Commission staff to account for an 1800 hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

155 Based on data from Form N-MFP and iMoneyNet data as of February 28, 2014.

156 This estimate is based on the following calculation: 9 hours x 84 money market fund complexes = 756 hours.

157 This estimate is based on the following calculation: $2,838 x 84 money market fund complexes = $238,392.
eligibility of a fund’s portfolio securities. Amortizing these hourly and cost burdens over three years results in an average annual increased burden for all money market fund complexes of 252 hours\footnote{This estimate is based on the following calculation: 756 hours ÷ 3 years = 252 hours.} at a cost of $79,464.\footnote{This estimate is based on the following calculation: $238,392 ÷ 3 years = $79,464.} We do not believe that funds would newly implement or change any annual review of policies and procedures that they currently perform as a result of the re-proposed amendments. There would be no external costs associated with this collection of information.

2.  

Monitoring Minimal Credit Risks

Rule 2a-7 currently 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.\footnote{See rule 2a-7(f)(1)(i).} As discussed above, we are re-proposing amendments to rule 2a-7 that would eliminate the current use of credit ratings in the rule’s downgrade and default provisions. Rule 2a-7 instead would require a money market fund to adopt written procedures requiring the fund adviser, or any person to whom the fund’s board of directors has delegated portfolio management responsibilities, to provide ongoing review of each portfolio security to determine that the issuer continues to present minimal credit risks.\footnote{Re-proposed rule 2a-7(g)(3); see supra section II.A.3.} To comply with these re-proposed amendments, if adopted, a fund complex would incur one-time costs to review the amended provisions of rule 2a-7 and adopt policies and procedures providing for ongoing review to determine whether a money market fund’s portfolio securities continue to present minimal credit risks. Money market funds are not currently required to maintain policies and procedures that specifically address ongoing minimal credit risk monitoring. Although we understand, based on
staff experience, that most money market funds currently monitor portfolio securities for minimal credit risk on an ongoing basis, we are assuming that all money market fund complexes would need to adopt new written policies and procedures to provide for this ongoing review in order to comply with the amended provisions of rule 2a-7.

We estimate that each money market fund complex on average would incur a one-time burden of 5 hours, at a cost of $3,619, to adopt policies and procedures for ongoing review of minimal credit risks. Using an estimate of 84 money market fund complexes, we estimate that money market funds would incur, in aggregate, a total one-time burden of 378 hours, at a

162 See supra notes 102-106 and accompanying text.

163 These hour estimates assume that the process of adopting written policies and procedures will consist primarily of transcribing and reviewing any existing policies and procedures that funds currently use when monitoring minimal credit risk on an ongoing basis. Because we cannot predict the extent to which funds may need to develop these policies and procedures to comply with the amended provisions of rule 2a-7, if adopted, or may need to transcribe and review any existing policies and procedures, we have taken, as an estimated average burden, the mid-point of a range of hour estimates discussed below in this note 163 for purposes of our PRA analysis.

We estimate that the lower range of the one-time hour burden for a money market fund complex to adopt policies and procedures for ongoing review to determine whether a money market fund’s portfolio securities continue to present minimal credit risks would be 3.5 hours (2 hours by a compliance manager and 1 hour by an attorney to develop and review policies and procedures (or transcribe and review pre-existing policies and procedures) + 0.5 hours for the fund’s board to adopt the policies and procedures). We estimate that the upper range of the one-time hour burden for a money market fund complex to adopt such policies and procedures would be 6.5 hours (4 hours by a compliance manager and 2 hours by an attorney to develop and review policies and procedures (or transcribe and review pre-existing policies and procedures) + 0.5 hours for the fund’s board to adopt the policies and procedures). The mid-point of the lower range estimate and the upper range estimate is 5 hours.

164 This estimate is based on the following calculation: (3 hours (mid-point of 2 hours and 4 hours incurred by a compliance manager) x $283 (rate for a compliance manager) = $849) + (1.5 hours (mid-point of 1 hour and 2 hours incurred by an attorney) x $380 (rate for an attorney) = $570) + (0.5 hours x $4,400 per hour for a board of 8 directors = $2,200) = $3,619. The staff previously estimated in 2009 that the average cost of board of director time was $4,000 per hour for the board as a whole, based on information received from funds and their counsel. Adjusting for inflation, the staff estimates that the current average cost of board of director time is approximately $4,400.

165 Based on data from Form N-MFP and iMoneyNet data as of February 28, 2014.

166 This estimate is based on the following calculation: 4.5 hours x 84 money market fund complexes
cost of $303,996\textsuperscript{,167} to comply with the amended provisions of rule 2a-7. Amortizing these hourly and cost burdens over three years results in an average annual increased burden for all money market fund complexes of 126 hours\textsuperscript{168} at a cost of $101,332.\textsuperscript{169} There would be no external costs associated with this collection of information.

3. **Stress Testing**

Rule 2a-7 currently requires money market funds to adopt written stress testing procedures and to perform stress tests according to these procedures on a periodic basis.\textsuperscript{170} We are re-proposing amendments to rule 2a-7 that would replace the reference to ratings downgrades in the rule’s stress testing provisions with a hypothetical event that is designed to have a similar impact on a money market fund’s portfolio.\textsuperscript{171} The re-proposed amendment is designed to retain a similar standard for stress testing as under current rule 2a-7. Specifically, while rule 2a-7 currently requires a fund to stress test its portfolio based on certain hypothetical events, including a downgrade of portfolio securities, the re-proposed amendment would require a fund to stress test for an event indicating or evidencing credit deterioration in a portfolio security, and would include a downgrade or default as examples of that type of event. As discussed below, we recognize that a money market fund could use its current policies and procedures to comply with the re-proposed amendment, and could continue to use credit quality evaluations prepared by

\textsuperscript{167} This estimate is based on the following calculation: $3,619 \times 84 \text{ money market fund complexes} = $303,996.

\textsuperscript{168} This estimate is based on the following calculation: 378 hours ÷ 3 years = 126 hours.

\textsuperscript{169} This estimate is based on the following calculation: $303,996 ÷ 3 years = $101,332.

\textsuperscript{170} See rule 2a-7(g)(8).

\textsuperscript{171} Re-proposed rule 2a-7(g)(8)(i)(B); see supra section II.A.4.
outside sources, including NRSRO downgrades, in stress tests. Because the rule currently requires testing for a downgrade as a hypothetical event, we do not believe that funds would take any additional time to review and revise their policies and procedures with respect to the continued use of downgrades in stress testing. Accordingly, we do not expect the proposed amendments would significantly change current collection of information burden estimates for rule 2a-7.173

Total Burden for Rule 2a-7. The current approved collection of information for rule 2a-7 is 517,228 annual aggregate hours. The aggregate additional burden hours associated with the re-proposed amendments to rule 2a-7 increase the burden estimate to 517,606 hours annually for all funds.175

4. Request for Comment

We request comment on these assumptions and estimates. If commenters believe these assumptions or estimates are not accurate, we request they provide specific data that would allow us to make more accurate estimates.

B. Rule 30b1-7 and Form N-MFP

See infra text accompanying and preceding note 217.

See infra note 174.

The Commission has submitted an application to the OMB for revision of the current approved collection of information for rule 2a-7 in connection with the 2014 Money Market Fund Adopting Release. When and if approved, the collection of information for rule 2a-7 will increase to 617,653 hours annually for all funds.

This estimate is based on the following calculation: 517,228 hours (current approved burden) + 252 hours (eligible security determinations for money market fund portfolio securities, including securities that are subject to a conditional demand feature) + 126 hours (monitoring minimal credit risks) = 517,606 hours. If the revised collection of information for rule 2a-7 in connection with the 2014 Money Market Fund Adopting Release is approved, as well as the collection of information associated with the re-proposed amendments to rule 2a-7 as discussed in this release, the collection of information for rule 2a-7 would increase to 618,031 hours (617,653 hours + 252 hours + 126 hours). See supra note 174.
Rule 30b1-7 requires money market funds to file a monthly report electronically on Form N-MFP within five business days after the end of each month. The information required by the form must be data-tagged in XML format and filed through EDGAR. Preparing Form N-MFP is a collection of information under the PRA. The respondents to this collection of information are money market funds. A fund must comply with the requirement to prepare Form N-MFP in order to hold itself out to investors as a money market fund or the equivalent of a money market fund in reliance on rule 2a-7. Responses to the disclosure requirements of Form N-MFP are not kept confidential.

Money market funds are currently required to disclose on Form N-MFP, with respect to each portfolio security, whether the security is a first or second tier security or is unrated, as well as the “designated NRSROs” for each security (and for each demand feature, guarantee, or credit enhancement). As discussed above, the re-proposed amendments would require that each money market fund disclose on Form N-MFP, for each portfolio security, 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). Because we believe that the majority of funds would continue to refer to credit ratings in making minimal credit risk determinations, we do not believe the re-proposed amendments to Form N-MFP would result in material changes to the

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176 For purposes of the PRA analysis, the current burden associated with the requirements of rule 30b1-7 is included in the collection of information requirements of Form N-MFP. See infra note 188.

177 See Form N-MFP Items C.9, C.10, C.14.b-e, C.15.b-e, C.16.c-d.

178 See re-proposed Form N-MFP Items C.9, C.10, C.14.e, C.15.c, C.16.d; supra section II.B.
ongoing burden for most funds. However, we believe that funds will incur one-time costs to re-program their filing software to reflect the new requirements of Form N-MFP.

We estimate that each fund will incur a one-time burden of 3 hours, at a cost of $943 per fund, to comply with the amended disclosure requirements of Form N-MFP, if adopted. Using an estimate of 559 money market funds that are required to file reports on Form N-MFP, we estimate that money market funds would incur, in the aggregate, a total one-time burden of 1,677 hours at a cost of $527,137 to comply with the amended disclosure requirements of Form N-MFP. Amortizing these hourly and cost burdens over three years results in an average annual increased burden for all money market funds of 559 hours at a cost of $175,712. There would be no external costs associated with complying with the amended disclosure requirement of Form N-MFP.

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179 See infra note 204 and accompanying paragraph.

180 We estimate that the one-time hour burden for a money market fund to re-program its Form N-MFP filing software to reflect the new requirements of Form N-MFP would be 3 hours (1 hour by a senior systems analyst, 1 hour by a senior programmer, and 1 hour by an attorney).

181 This estimate is based on the following calculation: (1 hour x $260 (rate for a senior systems analyst) = $260) + (1 hour x $303 (rate for a senior programmer) = $303) + (1 hour x $380 (rate for an attorney) = $380) = $943.

182 This estimate is based on a review of reports on Form N-MFP filed with the Commission for the month ended February 28, 2014.

183 This estimate is based on the following calculation: 3 hours x 559 money market funds = 1,677 hours.

184 This estimate is based on the following calculation: $943 x 559 money market funds = $527,137.

185 This estimate is based on the following calculation: 1,677 hours ÷ 3 years = 559 hours.

186 This estimate is based on the following calculation: $527,137 ÷ 3 years = $175,712.

187 We understand that a certain percentage of money market funds that report information on Form N-MFP license a software solution from a third party that is used to assist the funds to prepare and file the required information, and that a certain percentage of money market funds retain the services of a third party to provide data aggregation and validation services as part of the preparation and filing of reports on Form N-MFP. See 2014 Money Market Fund Adopting Release, supra note 8, at text accompanying nn. 2334-2336.
The current approved collection of information for Form N-MFP is 45,214 annual aggregate hours and $4,424,480 in external costs.\textsuperscript{188} The aggregate additional hours associated with the re-proposed amendments to Form N-MFP increase the burden estimate to 45,773 hours annually for all funds.\textsuperscript{189} Because we estimate no external costs associated with complying with the amended Form N-MFP disclosure requirements, the annual external costs associated with the Form N-MFP collection of information would remain $4,424,480.

We request comment on these estimates. If commenters believe these estimates are not accurate, we request they provide specific data that would allow us to make more accurate estimates.

V. ECONOMIC ANALYSIS

As discussed above, we are re-proposing amendments to rule 2a-7 and Form N-MFP under the Investment Company Act to implement section 939A of the Dodd-Frank Act, which requires the Commission, to “review any regulation issued by [the Commission] that requires the use of an assessment of the credit-worthiness of a security or money market instrument and any

\textsuperscript{188} The Commission has submitted an application to the OMB for revision of the current approved collection of information for Form N-MFP in connection with the 2014 Money Market Fund Adopting Release. When and if approved, the collection of information for Form N-MFP will increase to 83,412 hours.

\textsuperscript{189} This estimate is based on the following calculation: 45,214 hours (current approved burden) + 559 hours = 45,773 hours. If the revised collection of information for Form N-MFP in connection with the 2014 Money Market Fund Adopting Release is approved, as well as the collection of information associated with the re-proposed amendments to Form N-MFP as discussed in this release, the collection of information for Form N-MFP would increase to 83,971 hours (83,412 hours + 559 hours). See supra note 188.
references to or requirements in such regulations regarding credit ratings.”190 That section further provides that the Commission shall “modify any such regulations identified by the review . . . to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as [the Commission] shall determine as appropriate for such regulations.”191

We also are proposing to amend rule 2a-7 to eliminate the exclusion to the issuer diversification requirement for securities subject to a guarantee issued by a non-controlled person. As a result, most non-government securities subject to a guarantee (including an asset-backed security with a presumed sponsor guarantee) would have to comply with both the 5 percent diversification requirement for issuers (including SPE issuers) and the 10 percent diversification requirement for guarantors and providers of demand features.192

The economic baseline for our economic analysis is the regulatory framework as it exists immediately before the re-proposal, that is, the regulatory framework after the amendments to rule 2a-7 were adopted today in the 2014 Money Market Fund Adopting Release. As discussed in more detail below, that adopting release makes material changes to money market fund regulation that we believe may result in material changes to the money market fund industry.

190 Pub. L. No. 111-203 § 939A(a)(1)-(2). Section 939A of the Dodd-Frank Act applies to all federal agencies.

191 Pub. L. No. 111-203 § 939A(b). Section 939A of the Dodd Frank Act provides that agencies shall seek to establish to the extent feasible, uniform standards of creditworthiness, taking into account the entities the agencies regulate and the purposes for which those entities would rely on such standards.

192 As discussed above, the asset-backed security presumed guarantee is counted toward the 10% limitation on guarantees and demand features provided by the same institution. Up to 15% of the value of securities held in a tax-exempt money market fund’s portfolio may be subject to guarantees or demand features for a single institution, and up to 25% of the value of securities held in a single state money market fund portfolio may be issued by any single issuer. See supra notes 125-126.
Because there is an extended compliance period for those amendments, we do not know how market participants, including money market fund managers selecting portfolio securities, may react as a result. Thus, we are not able to provide quantitative estimates for the incremental effects of our re-proposal. For example, under the baseline, institutional prime money market funds have floating NAVs and maintain the distinction between first and second tier securities. We are unable to estimate how institutional prime funds will choose to allocate their portfolios among first and second tier securities under our re-proposal when they have floating NAVs. We can describe potential economic effects of complying with the re-proposed and proposed amendments to the rule, but without knowing how fund portfolio allocations may change, we cannot quantify these potential effects. For the remainder of our economic analysis, we discuss separately the re-proposed rule 2a-7 amendments to remove and replace ratings references, the re-proposed Form N-MFP amendments, and the proposed amendments to rule 2a-7’s issuer diversification provision.

A. Rule 2a-7

The re-proposed amendments to rule 2a-7 would affect five elements of the rule. These are: (i) determination of whether a security is an eligible security; (ii) determination of whether a security is a first tier security; (iii) credit quality standards for securities with a conditional demand feature; (iv) requirements for monitoring securities for ratings downgrades and other credit events; and (v) stress testing. The re-proposed amendments, which are similar to those we proposed in 2011, are designed to remove any requirement of reliance on credit ratings and to substitute standards of creditworthiness that we believe are appropriate.

193 The re-proposed rule also would make conforming amendments to rule 2a-7’s recordkeeping and reporting requirements. See re-proposed rule 2a-7(h)(3).
1. Economic Baseline

As discussed above, the credit risk limitations in rule 2a-7 currently require that money market funds undertake a two-step analysis before acquiring a portfolio security. First, funds must determine whether a security has received credit ratings from the “requisite NRSROs” in one of the two highest short-term rating categories or, if the security is unrated, determine that it is of comparable quality. A money market fund must invest at least 97 percent of its portfolio in first tier securities, which are eligible securities that have received a rating from the requisite NRSROs in the highest short-term rating category for debt obligations (or unrated securities of comparable quality). Second, the fund’s board of directors (or its delegate) must determine that the security presents minimal credit risks, “based on factors pertaining to credit quality in addition to any rating assigned to such securities by a designated NRSRO.” In addition, under rule 2a-7, a security subject to a conditional demand feature may be determined to be an eligible security or a first tier security if, among other conditions: (i) the conditional demand feature is an eligible security or a first tier security, and (ii) the underlying security (or its guarantee) has received either a short-term rating or a long-term rating, as the case may be, within the highest two categories from the requisite NRSROs or is a comparable unrated security.

Based on Form N-MFP filings from February 28, 2014, the Commission estimates that 99.75 percent of aggregate money market fund assets are in first tier securities, 0.24 percent of aggregate money market fund assets are in second tier securities, and 0.01 percent of aggregate money market fund assets are in unrated securities. Among the 559 funds that filed Form N-MFP that month, we estimate that 488 funds held only tier one rated securities, 503 funds held

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194 See supra notes 20-25 and accompanying text. The credit risk limitations of rule 2a-7, as well as the other specific provisions of rule 2a-7 that reference credit ratings, were not changed by the adoption of the amendments discussed in the 2014 Money Market Fund Adopting Release.
no tier two rated securities, and 537 funds held no unrated securities. In addition, less than 5 percent of all money market funds, and only 6 prime funds out of 229 prime funds held the maximum amount of second tier securities permitted under rule 2a-7. Using additional data from the Federal Reserve Board, we estimate that money market fund holdings of second tier commercial paper represent 5.1 percent of the outstanding issues of second tier commercial paper.\footnote{195}{This data is based on the Federal Reserve Board’s statistics on outstanding volume of commercial paper. \textit{See} Commercial Paper Outstanding by special categories, \textit{available at} \url{http://www.federalreserve.gov/releases/cp/outstanding.htm}.}

Securities subject to a conditional demand feature are typically variable rate demand notes issued by municipalities that have a conditional demand feature issued by a bank. Based on Form N-MFP filings as of February 28, 2014, the Commission estimates that 11 percent of money market fund assets are invested in securities with a demand feature. We estimate further that securities with conditional demand features represent 25 percent of securities with demand features and 3 percent of all securities held by money market funds. We further estimate that 81 percent of those underlying securities (or their issuers or guarantors) have received an NRSRO rating in the second-highest long-term rating category, while 19 percent have received an NRSRO rating in the highest long-term category.\footnote{196}{An underlying long-term security would become a short-term security when its remaining time to maturity is less than 397 days. \textit{See supra} note 78. These estimates are based on a random sample of 10\% of the securities that have demand features that were reported in February 2014 Form N-MFP filings.}

Rule 2a-7 currently 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.\footnote{197}{\textit{See supra} notes 91-92 and accompanying text.} We understand that downgrades are rare among money market fund
portfolio securities. As discussed above, we believe, based on staff experience, that most, if not all, money market funds currently monitor portfolio securities for minimal credit risk on an ongoing basis. We assume for purposes of this analysis, however, that these funds do not have written policies and procedures that specifically address ongoing minimal credit risk monitoring.

Finally, rule 2a-7 currently requires money market funds to stress test their portfolios. Under the rule, a money market fund’s board of directors must adopt written procedures to test the ability of a fund to maintain at least 10 percent of its total assets in weekly liquid assets and minimize principal volatility (and, in the case of a money market fund using the amortized cost method of valuation or penny rounding method of pricing, the fund’s ability to maintain a stable share price per share) based on certain hypothetical events, including a downgrade or default of particular portfolio security positions, each representing various portions of the fund’s portfolio. We believe that funds stress test at least monthly.

2. Economic Analysis

The re-proposed amendments to rule 2a-7 would assist in further implementing section 939A of the Dodd-Frank Act. These amendments are designed to establish credit quality standards similar to those currently in the rule. By replacing references to credit ratings, the re-proposed amendments may, particularly when considered together with other amendments the

198 See, e.g., Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher, a report by staff of the Division of Risk, Strategy, and Financial Innovation (Nov. 30, 2012), available at http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf, at 14-16 (discussing events such as credit rating downgrades that have led money market fund sponsors to choose to provide support to the fund or to seek staff no-action assurances permitting such support).

199 See supra notes 102-106 and accompanying text.

200 Rule 2a-7(g)(8).

201 See 2014 Money Market Fund Adopting Release, supra note 8, at section IV.A.5.
Commission has adopted that remove credit ratings references in other rules and forms under the federal securities laws, contribute to the Dodd-Frank Act goals of reducing perceived government endorsement of NRSROs and over-reliance on credit ratings by market participants.  

**Eligible securities.** Under the re-proposal, a money market fund board (or its delegate) would be required to determine minimal credit risk by applying a subjective credit quality standard. Because the interpretation of this subjective standard may differ among fund boards and their advisers, the possible range of securities available for investment may differ from that under the current rule if the re-proposed standard is adopted. Aggressive risk assessments may result in a broader set of securities holdings through investments in more second tier securities with a wider range of credit quality, while conservative risk assessments may result in a more restricted set of securities holdings with a narrower range of credit quality. We believe that fund managers are generally unlikely to increase exposure of their funds to riskier second tier securities in light of both current market practices and amendments to rule 2a-7 adopted in the 2014 Money Market Fund Adopting Release.  

First, we anticipate that many money market funds are likely to retain their current investment policies, which incorporate NRSRO ratings and would be permitted under the re-proposed rule amendments. Indeed, we understand that many funds today have investment policies that are more restrictive than rule 2a-7 requires, including

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202 See Report of the House of Representatives Financial Services Committee to Accompany H.R. 4173, H. Rep. No. 111-517 at 871 (2010). But see infra notes 209-210 and accompanying text (discussing a commenter’s view that the Commission’s re-proposal to eliminate credit ratings could actually increase money market fund investor reliance on credit ratings).

203 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.
policies that, for example, limit investments to first tier securities. As a result, we do not expect that these money market funds would change current policies and procedures they have adopted that limit their investments to those assigned the highest NRSRO ratings. We also note that according to Form N-MFP filings from February 28, 2014, fund assets in second tier securities represented 0.24 percent of total money market fund assets and that 24 funds (out of a total of 559) currently hold the maximum amount of second tier securities permissible under rule 2a-7. We do not anticipate that money market funds representing the significant majority of assets under management are likely to increase substantially their investments in riskier securities as a result of our proposal because these funds do not currently invest in second tier securities to the extent permitted now.

Second, as discussed above, the new amendments to rule 2a-7 may reduce the potential that funds would invest in riskier securities. Under the reforms, money market funds other than government money market funds are subject to fees and gates, while institutional prime money market funds will be required to transact at a floating NAV. We believe that these

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204 As of February 28, 2014, 179 money market funds, representing approximately 59% of all money market funds assets (88% of all institutional money market fund assets) were invested in money market funds that were themselves rated by credit rating agencies, and approximately 98% of rated money market funds were rated first tier. For a money market fund to receive a first tier rating, credit rating agencies generally require the fund to limit its portfolio securities to first tier securities. See, e.g., FitchRatings, Global Money Market Fund Rating Criteria (Mar. 26, 2013), available at http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=704145 (registration required) (stating that its “AAAmmf” top rating requires that a money market fund have 100% of its portfolio securities rated first tier (“F1+” or “F1”)); Standard & Poor’s, Methodology: Principal Stability Fund Ratings (June 8, 2011), available at https://www.sbafla.com/prime/portals/8/RiskMan_Oversight/FundProfile/201106_SPPrincipalStabilityFundRatingsMethodology.pdf (stating that “[i]n order for a fund to be eligible for an investment-grade rating, all investments should carry a Standard & Poor's short-term rating of 'A-1+' or 'A-1' (or SP-1+ or SP-1), or Standard & Poor's will consider all of the investments to be of equivalent credit quality”).

205 Rule 2a-7(a)(16) defines a government money market fund as a money market fund that invests 99.5% or more of its total assets in cash, government securities, and/or repurchase agreements that are collateralized fully. See supra note 15.
amendments may encourage non-government funds to more closely monitor fund liquidity and hold more liquid securities to increase the level of daily and weekly liquid assets in the fund because doing so will tend to lessen the likelihood of a fee or gate being imposed. The newly-adopted money market fund reforms also require each fund daily to disclose its market value rounded to four decimal points (or an equivalent level of accuracy for a fund using a share price other than $1.0000^{206}$) and to depict historical information about its daily NAV for the previous six months. These disclosures may increase informational efficiency by allowing investors to see variations in share value that are not apparent in the share price and compare the principal volatility among funds over time. As a result, to the extent that institutional investors continue to value price stability and can see these variations in share value, we believe that institutional prime funds will endeavor to reduce NAV fluctuations.

Third, funds are permitted to refer to credit ratings while making their minimal credit risk determinations. A first tier credit rating might help support the fund’s determination that the security is an eligible security, while a second tier credit rating might not support the same determination. Thus, fund managers may have to perform additional credit research and analysis on the issuers of second tier securities in order to determine whether the investment would be permitted under the re-proposed amendments. We believe that many fund managers may not wish to invest in the additional resources necessary to make this assessment with respect to second tier securities unless the fund believes that the expected risk-adjusted return of doing so would be greater than the expected costs.

The re-proposal would eliminate the current limitations on fund investments in second

\[206\] See supra note 49.
tier securities. As a result, funds may increase their holdings of second tier securities despite the considerations discussed above. We believe that, to the extent money market funds increase investments in riskier securities, institutional prime funds are more likely than stable-NAV funds to do so because only stable-NAV funds will break the buck if the economic value of the underlying portfolio changes too much. While some shareholders may continue to demand price stability rather than high yield from institutional prime funds, if enough shareholders prefer yield over price stability, institutional prime funds will be incentivized to increase their investments in second tier securities. Allocative efficiency may improve if such preferences result in relatively riskier securities moving from the portfolios of stable-NAV funds to the portfolios of institutional prime funds because the reallocation may enable money market fund shareholders to choose funds that better match their preferences for risk and return. We do not, however, know whether institutional prime funds with floating NAVs, which will have to compete with other money market funds, including stable-NAV government funds, will focus on maintaining comparatively stable NAVs or on generating comparatively high yields.

Under the assumption that money market funds would increase their relative holdings of second tier securities if the re-proposed amendments were adopted, the effects on competition and capital formation will depend, in part, on whether the increased second tier investments come from new assets outside the funds, which when invested by money market funds are disproportionately invested in second tier securities or whether the increased second tier investments will come from a shift of assets from first tier securities to second tier securities. If the former, the effects of competition between issuers of first and second tier securities might be small, and capital formation might improve in the second tier market as the size of the new

See supra notes 25 and 43 and accompanying text.
investment increases. If the latter, an increase in capital formation from issuers of second tier securities may result in a corresponding decrease in capital formation from issuers of first tier securities, which, in turn, may lead to increased competition between issuers of first and second tier securities. We are unable to estimate these effects because we do not know how shareholders and funds will respond to the elimination of the current limitation on fund investments in second tier securities.

The re-proposed amendments to Form N-MFP, which are discussed in more detail below, may reduce the potential that fund boards (or managers) that use credit ratings will increase significantly fund investments in second tier securities beyond the level desired by fund shareholders. We would require each money market fund to disclose on Form N-MFP those NRSRO ratings the fund’s board (or its delegate) has considered, if any, in determining whether a security presents minimal credit risks. The disclosure to investors of these risk indicators may have the effect of penalizing funds that assume a level of risk that is different from that which is desired by their shareholders.

As discussed above, the vast majority of money market funds held no second tier securities on February 28, 2014, and few funds held the maximum permissible 3 percent. We therefore believe that a reduction or even elimination of second tier securities from the money market fund industry’s aggregate portfolio will not likely have a material effect on issuers of either first or second tier securities. However, removing second tier securities from the portfolios of individual money market funds may negatively affect yields in certain funds, especially during periods when second tier securities offer substantially higher yields than the yields offered by first tier securities.

One commenter suggested that eliminating references to credit ratings in the definition of
eligible security would lead to more unrated securities issuances in the market.208 The commenter argued that some issuers of money market instruments might forego the expense of ratings because they would face greater uncertainty as to market acceptance under the subjective determinations of money market fund advisers. In addition, some issuers of instruments that might not receive a rating in the highest category might choose not to obtain a rating. This commenter opined that such a result would make it more difficult to retain a degree of risk limitation similar to that in the current rule.

We believe that most money market funds would not likely change their current investment policies if the re-proposed amendments were adopted. Nevertheless, we recognize that some fund boards might choose not to consider NRSRO ratings in their credit assessments or as noted above, fewer securities may be rated. If, as a result, the demand for NRSRO ratings were reduced significantly, NRSROs might invest less in producing quality ratings. The importance attached to NRSRO ratings currently as a result of the history of their use in regulatory requirements may impart franchise value to the NRSRO rating business. By eliminating references to NRSRO ratings in federal regulations, section 939A of the Dodd-Frank Act could reduce these franchise values and reduce NRSROs’ incentives to produce credible and reliable ratings. In addition, eliminating the required use of credit ratings in Commission rules and forms may reduce the incentive for credit rating agencies to register as NRSROs with the Commission, which registration subjects them to Commission oversight and the statutory and regulatory requirements applicable to NRSROs. If the quality and accuracy of NRSRO ratings were adversely affected yet the ratings continued to be used by enough other parties, the capital allocation process and economic efficiency might be impaired.

208 See Schwab Comment Letter, supra note 30.
Another commenter stated that our re-proposal to eliminate references to credit ratings could increase investor reliance on credit ratings.\textsuperscript{209} This commenter stated that to the extent that investors cannot be reassured that money market funds are investing in rated securities, they can reasonably be expected to seek the “reassurance” ratings provide in other ways. Specifically, investors could seek rated funds in even greater numbers “as the ratings, and the investment guidelines that underlie them, will provide an objective standard that investors can use to distinguish amongst funds,” which would encourage more funds to become rated.\textsuperscript{210} If, as a result of the re-proposed amendments, currently unrated money market funds obtain ratings to compete in the market, it could increase their costs. Such a result also might increase rather than reduce investor reliance on credit ratings. To the extent that funds continue to use ratings, which we believe most will, investors would be able to determine the ratings of fund portfolio securities from the disclosures required under the re-proposed amendments to Form N-MFP.

In our discussion above, we have suggested guidance that a fund board (or its delegate) should consider in making credit quality assessments. As we noted, based on staff observations in examinations and prior staff guidance, we assume that most money market fund managers currently take these factors into account, as appropriate, when they determine that a portfolio security presents minimal credit risks. Moreover, as noted above, the guidance is not intended to define the parameters of an appropriate credit quality assessment; that is for the fund’s board and its adviser to determine with respect to each particular portfolio security. Thus, we do not anticipate that the re-proposal’s discussion of factors that a fund manager should consider would significantly change the process for evaluating credit quality or that consideration of the factors

\textsuperscript{209} \textit{See} Comment Letter of Wells Fargo Funds Management, LLC (Apr. 25, 2011).

\textsuperscript{210} \textit{Id.} The comment letter stated that over 80\% of institutional assets were in rated money market funds.
listed above would significantly impact the holdings in money market fund portfolios. For these reasons, we believe that the guidance will not have a material effect on efficiency, competition, or capital formation. Funds may, however, consider whether their policies and procedures for credit quality assessment should be revised in light of the guidance, and, as a result, may update them.

**Conditional Demand Feature.** The re-proposed amendments would replace the current objective standard for determining the credit quality of an underlying security with a subjective standard, which is based on the qualitative standard NRSROs use to describe a security with the second-highest long term rating. We recognize that fund managers could interpret this subjective standard in different ways, which could widen the range of credit quality in underlying securities in which money market funds invest. However, we do not believe that fund managers will likely interpret this subjective standard in a manner that results in funds increasing the risk profiles of their underlying securities. For the reasons discussed above, we do not believe that securities that are rated by NRSROs in the third-highest category for long-term ratings (or comparable unrated securities) would satisfy the proposed standard that the issuer of underlying securities have a very strong capacity to meet its financial commitments.\(^{211}\) We also note that funds currently can invest exclusively in underlying securities rated in the second-highest category if

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\(^{211}\) See text accompanying *supra* note 84. Securities with these ratings generally have expectations of low credit risk or have obligors have only a strong capacity to meet their financial commitments. See Moody’s Ratings Definitions, *supra* note 38, at 5 (long-term obligations “rated A are judged to be upper-medium grade and are subject to low credit risk.”); Fitch Ratings Scales, *supra* note 38, at 9 (long-term “A ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong.”); S&P Ratings Definitions, *supra* note 38, at 4 (a long-term obligation “rated ‘A’ is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.”).
the instrument meets the other conditions for eligibility.\textsuperscript{212} We estimate that most underlying securities held by money market funds (81 percent) are rated in the second-highest long-term category, and a smaller portion (19 percent) are rated in the highest long-term category.\textsuperscript{213} For these reasons, we have no reason to anticipate that funds are likely to increase the portion of their underlying securities that are rated in the second-highest long-term category as a result of the re-proposed amendments. Because we believe that our re-proposal will result in only small changes to the behavior of funds with respect to investments in securities with conditional demand features, we believe that this re-proposed amendment will result in little to no effect on efficiency, competition, or capital formation for either funds or issuers.

As discussed above, we believe that if the re-proposed amendments to rule 2a-7 were adopted, money market fund complexes would incur certain costs in reviewing and updating their policies and procedures. Specifically, each complex would review the amendments to the credit quality standards in rule 2a-7 and, as it determines appropriate in light of the amendments, revise its policies and procedures to incorporate the amended credit quality standards to be used in determining the eligibility of a money market fund’s portfolio securities, including securities that are subject to a conditional demand feature.

Monitoring Minimal Credit Risk. As discussed above, we believe the re-proposed requirement that each money market fund adopt written policies and procedures for ongoing monitoring of minimal credit risks for each portfolio security essentially codifies the current practices of fund managers, which are already explicit (and implicit) in several provisions of the

\textsuperscript{212} Rule 2a-7(d)(2)(iv).
\textsuperscript{213} See supra note 196 and accompanying text.
rule and are discussed above. Although based on staff experience we believe that most, if not all, money market funds currently monitor portfolio securities for minimal credit risk on an ongoing basis (as rule 2a-7 requires), we note that money market funds are not currently required to maintain written policies and procedures that specifically address monitoring. We believe that to the extent that some money market funds may not have written procedures to regularly monitor minimal credit risks, our re-proposal to require such procedures is designed to ensure that funds are better positioned to identify quickly potential risks of credit events that could impact portfolio security prices. The costs associated with the re-proposed minimal credit risk monitoring requirement, as discussed above, will vary based on the extent to which funds’ existing procedures need to be transcribed and reviewed. We believe that the written-procedure requirement in the re-proposal will not materially affect efficiency, competition, or capital formation because we expect no material changes in how funds invest.

Stress Testing. As discussed above, the re-proposed amendments are designed to retain similar standards for stress testing as under current rule 2a-7. Specifically, while the re-proposed amendments would replace the current reference to ratings downgrades in the rule 2a-7 stress testing requirement, the amendments would instead require funds to test for an event indicating or evidencing credit deterioration of particular portfolio security positions, each representing various positions of the fund’s portfolio, and include a downgrade or default as examples of such an event. Consequently, we recognize that a money market fund could use its current policies and procedures for stress testing, including testing for a downgrade, to comply with the

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214 See supra notes 91-92, 102-106 and accompanying text.
215 See id.
216 See supra note 163.
proposed amendments. And we believe that funds will do so because a downgrade by a relevant NRSRO may impact the price of a portfolio security.\textsuperscript{217} Because we believe that funds will not change their stress testing policies and procedures in response to this re-proposed amendment, we do not believe there would be any costs associated with it.\textsuperscript{218} Thus we do not anticipate that this re-proposed amendment is likely to impact efficiency, competition, or capital formation.

Policies and Procedures. As discussed above, money market funds have written policies and procedures for complying with rule 2a-7, including policies and procedures for determining and reassessing minimal credit risk and for stress testing the portfolio.\textsuperscript{219} Although our re-proposal would not require changes to these policies and procedures for most money market funds, we anticipate that funds would likely review them and may revise them in consideration of the standard provided in the re-proposal, if adopted. We also anticipate that after such a review, many fund boards and advisers would retain investment policies tied to NRSRO ratings required under the current rule.\textsuperscript{220} Although we cannot predict the number of funds that would review and revise their policies and procedures or the extent to which funds may do so, we estimate that each fund would incur, at a minimum, the collection of information costs discussed in the Paperwork Reduction Act section for a total average one-time cost of approximately

\textsuperscript{217} See ICI Comment Letter, \textit{supra} note 30.
\textsuperscript{218} See \textit{supra} text accompanying and following note 172.
\textsuperscript{219} See rule 38a-1(a).
\textsuperscript{220} See \textit{supra} paragraph including note 151. We also note that most commenters on the 2011 proposal supported permitting funds to continue to use ratings, and some asked us to clarify that ratings continue to be a permissible factor for boards or their delegates to consider in making credit quality determinations. See, e.g., BlackRock Comment Letter, \textit{supra} note 122; IDC Comment Letter, \textit{supra} note 30. Our re-proposed amendments to Form N-MFP, discussed above, reflect our clarification that ratings continued to be a permissible factor to use in making credit quality determinations.
$2,838 per fund complex.221 These minimum costs assume that a fund would review its policies and procedures in consideration of the re-proposed amendments and make minor changes to conform with revised rule text, but would not change significantly the policies and procedures relating to the fund’s credit quality assessments, monitoring for minimal credit risk or stress testing, which currently include consideration of NRSRO ratings.

As noted above, we believe that while funds monitor for minimal credit risks on an ongoing basis currently, we assume that funds do not have written policies and procedures to address monitoring.222 We estimate the average one-time costs to adopt those written policies would be $3,619 per fund.223 Because we anticipate that our re-proposal is not likely to change these fund policies significantly, we believe it is not likely to have a significant impact on efficiency, competition, or capital formation.

3. Alternatives

In addition to the re-proposed amendments to rule 2a-7, we considered adopting the amendments we proposed in 2011. That proposal would have required fund boards first to determine whether securities are eligible securities based on minimal credit risks, and second to distinguish between first and second tier securities based on subjective standards similar to those the ratings agencies have developed to describe their ratings. As discussed above, we have been persuaded by the concerns some commenters expressed on the 2011 proposal. In particular, as several commenters noted, a two-tier approach could be confusing without reference to objective standards, and fund advisers are likely to make many of the same considerations in evaluating

221 See supra note 154.
222 See supra notes 102-106 and accompanying text.
223 See supra note 164.
first and second tier securities. In addition, on balance, we believe that the re-proposed single standard may better reflect the risk limitation in the current rule. The 2011 Proposing Release described the standard for second tier securities in language similar to the descriptions NRSROs use for second tier securities, which fund managers might interpret as permitting funds to invest in riskier second tier securities to a greater extent than under our re-proposal, which is designed to limit investments in very high quality second tier securities. Such increased investments in riskier second tier securities would increase the risk profile of money market funds.

We also considered proposing a single standard that would require a minimal credit risk determination, but with a finding different from what we are re-proposing today. For example, the board could be required to find that the issuer or guarantor has a repayment capacity that reflects the standard that NRSROs articulate for second tier securities. We did not re-propose this alternative because of concerns that such a standard could lower the credit quality of money market fund portfolios. Under this single standard, there would be no distinction between first tier and second tier securities and no limitation on fund holdings of second tier securities, unlike the current rule, which limits a money market fund to investing no more than 3 percent of its total assets in second tier securities. Without that investment limitation, a manager could invest a significantly greater portion of the fund’s portfolio in second tier securities, which could result in an increase in the portfolio risk of some funds that is inconsistent with the relevant risk limitations in the current rule. Both this alternative single standard approach and the two-tier approach discussed above could have different effects on competition and capital formation than the effects on competition and capital formation stemming from the re-proposed approach, as a result of ensuing increased or decreased investments in second tier securities. However, we are

See supra note 31 and accompanying text.
unable to estimate the relative effects on competition or capital formation because we do not know how shareholders and funds would respond to these approaches as compared to the re-proposed elimination of the current limitation on fund investments in second tier securities.

With respect to replacing the reference to ratings in determining the eligibility of underlying securities (i.e., those that are subject to a conditional demand feature), we considered a qualitative standard that NRSROs use to articulate long-term securities in the highest rating category. We note generally that few issuers or guarantors have received long-term ratings in the highest category. Moreover, issuers assigned a first tier short-term rating may have received a long-term rating in the second-highest category. Because of the limited NRSRO assignments of the highest long-term ratings to issuers, managers might interpret this alternative to preclude fund investments in a security subject to a conditional demand feature (that is itself an eligible security) if the underlying security’s issuer or guarantor is rated in the second-highest category. Such an interpretation could significantly deviate from the credit quality standards in the current rule, which is not our intent. It also would likely reduce money market fund investments in these securities.

In re-proposing to eliminate the current reference to ratings downgrades in the monitoring

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226 See Moody’s Ratings Definitions, supra note 38, at 6 (showing the linkage between short-term and long-term ratings when such long-term ratings exist); Standard &Poor’s, About Credit Ratings (2012), http://www.standardandpoors.com/aboutcreditratings/RatingsManual_PrintGuide.html (each short-term rating corresponds to a band of long-term ratings. For instance, the A-1 short-term rating generally corresponds to the long-term ratings of ‘A+,’ ‘A,’ and ‘A-’.”); FitchRatings, Ratings Definitions (2014), https://www.fitchratings.com/jsp/general/RatingsDefinitions.faces?context=5&detail=507&context Ln=5&detail Ln=500 (indicating the relationship between short-term and long-term ratings with a table and acknowledging that “lower relative short-term default risk, perhaps through factors that lend the issuer’s profile temporary support, may coexist with higher medium-or longer term default risk”).
standard of rule 2a-7, we considered the rule 2a-7 amendments that we proposed in 2011. 227

These proposed amendments would have required that, in the event the money market fund adviser (or any person to whom the board has delegated portfolio management responsibilities) becomes aware of any credible information about a portfolio security or an issuer of a portfolio security that suggests that the security is no longer a first tier security or a second tier security, as the case may be, the board or its delegate would have to reassess promptly whether the security continues to present minimal credit risks. 228 Most of those who commented on this proposed amendment objected to it as an inefficient method of notifying funds if a portfolio security is potentially impaired. As discussed in more detail above, we have been persuaded by commenters’ concerns in re-proposing a different standard than that proposed in 2011. 229

Finally, we also considered removing the current reference to ratings downgrades in the stress testing provisions of rule 2a-7 and replacing this reference with the requirement that money market funds stress test their portfolios for an adverse change in the ability of a portfolio security issuer to meet its short-term credit obligations. As discussed above, we proposed this alternative in 2011, and commenters on the 2011 proposal who addressed this issue uniformly advocated against removing the reference to a downgrade in the stress testing conditions. 230 We believe that the 2011 proposed standard, as compared to the standard we re-propose in this release, was less clear and that it would lead to more burdensome monitoring and greater inefficiencies in developing hypothetical events for stress testing. In light of these commenters’ concerns, we have thus decided to re-propose amendments to the stress testing provisions of rule

227 See supra notes 91-93 and accompanying text.
228 Id.
229 See supra notes 97-100 and accompanying text.
230 See supra notes 112-113 and accompanying text.
2a-7 that would permit funds to continue to test their portfolios against a potential downgrade or default, as discussed in more detail above.231

4. Request for Comment

We request comment on our estimates and assumptions regarding the costs and benefits of the re-proposed amendments to rule 2a-7 and the effects of these amendments on efficiency, competition, or capital formation. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),232 we also request information regarding the potential annual effect of the re-proposed amendments to rule 2a-7 on the U.S. economy. Commenters are requested to provide empirical data to support their views.

In addition to our general request for comment on the costs and benefits of the re-proposed amendments, we request specific comment on certain aspects of the amendments. What additional operational costs, if any, may result from making minimal credit risk determinations based on a subjective credit quality standard? Specifically, would the potentially broader range of securities available for investment that could result from a board’s interpretation of this standard produce additional or different costs than the current costs of determining minimal credit risks? Likewise, what additional operational costs, if any, may result from using a subjective standard for determining the credit quality of securities subject to a conditional demand feature? Would the potentially broader range of underlying securities available for investment produce additional or different costs than the current costs of evaluating the credit quality of underlying securities?

We have given guidance on the factors that advisers should consider, as appropriate, in

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231 See supra note 114 and accompanying text.
determining that a fund’s portfolio securities present minimal credit risk. To the extent that consideration of these factors is not consistent with current industry practice, how would funds benefit from consideration of these factors? Would this guidance result in money market funds or their advisers incurring additional costs, such as costs to change the process for evaluating credit quality? What type of costs would funds and advisers incur, and how much? With respect to our proposed requirement for money market funds to adopt written policies and procedures for ongoing monitoring of minimal credit risks to what extent do commenters currently have written policies and procedures covering this type of monitoring?

We also request comment on our re-proposed stress test amendments. Do commenters agree with our assessment that, under the amendments to rule 2a-7 that we re-propose, funds would retain downgrades by relevant NRSROs as hypothetical events for stress testing, as under current rule 2a-7? What hypothetical events are funds likely to use in addition to or in place of downgrades and why?

Finally, we request comment on the costs and benefits of the alternatives to the re-proposed amendments discussed above.

B. Form N-MFP

The re-proposed amendments would require money market funds to disclose NRSRO ratings in certain circumstances. Specifically, a fund would have to disclose for each portfolio security, (i) each rating assigned by any NRSRO if the fund or its adviser subscribes to that NRSRO’s services, as well as the name of the agency providing the rating, and (ii) any other NRSRO rating that the fund’s board of directors (or its delegate) considered in making its minimal credit risk determination, as well as the name of the agency providing the rating. NRSRO ratings provide one indicator of riskiness of a fund’s portfolio securities and, as
discussed above, we anticipate that they will continue to be considered by many money market fund managers in performing credit quality assessments. We believe this ratings information may be useful to the Commission, to investors, and to various third parties as they monitor and evaluate the risks that fund managers take in both stable-NAV and institutional prime funds. We believe that this ratings information might be especially useful during periods in which funds impose fees and/or gates even though ratings are not immediately updated.

1. Economic Baseline

Under the economic baseline outlined above, money market funds are required to disclose in Form N-MFP the credit ratings for each portfolio security. More specifically, the baseline form requires a fund to identify whether a portfolio security is a first or second tier security or is unrated, and it requires the fund to identify the “designated NRSROs” for each security (and for each demand feature, guarantee, or other credit enhancement). This disclosure requirement was not changed by the 2014 Money Market Fund Adopting Release.

As noted above, based on Form N-MFP filings from February 28, 2014, the Commission estimates that 99.75 percent of aggregate money market fund assets are invested in first tier securities, 0.24 percent of aggregate money market fund assets are invested in second tier securities, and 0.01 percent of aggregate money market fund assets are invested in unrated securities. Among the 559 funds that filed that month, we estimate that 488 funds held only tier one securities, 503 funds held no tier two securities, and 537 funds held no unrated securities.

2. Economic Analysis

We anticipate that our re-proposal is likely to have two primary benefits. First, it may contribute to eliminating perceived government endorsement of NRSROs and reducing over-reliance on credit ratings, particularly when considered together with other amendments the
Commission has adopted that remove credit ratings references in other rules and forms under the federal securities laws. Second, it will provide transparency on whether or not specific funds use credit ratings when making investment decisions, and, if credit ratings are used, it allows shareholders and other interested parties to use those ratings to make their own risk assessments.

We anticipate that our re-proposal is likely to have two primary costs. First, it may impose administrative costs on funds that need to re-program their Form N-MFP filing software. Second, because only funds that choose to consider credit ratings in assessing minimal credit risk will be permitted to disclose NRSRO ratings on Form N-MFP, our re-proposal may reduce transparency of risks taken by funds that do not choose to consider credit ratings. This loss of transparency could create additional servicing costs for such funds if shareholders demanded new communications regarding the credit quality of the portfolio.

The net effect of the re-proposed amendments to Form N-MFP is that funds could not disclose credit ratings if credit ratings are not considered in determining whether a security is eligible for the portfolio. However, as discussed above, we believe that our re-proposal will not result in any material changes for the majority of funds because they will, we believe, continue to refer to credit ratings. We believe, therefore, that the re-proposal’s effects on efficiency, competition, and capital formation likely will be negligible. To the extent that money market funds continue to consider NRSRO ratings in making their minimal credit risk determinations, the re-proposed amendments to Form N-MFP may reduce the potential that fund managers will increase significantly fund investments in riskier second tier securities; a fund would be required

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233 See supra notes 180-181 and accompanying text (discussion of re-programming costs in PRA analysis).

234 See Dreyfus Comment Letter supra note 30 (opposing the elimination of credit ratings disclosures in Form N-MFP because of the potential that the fund would bear increased shareholder servicing costs to provide additional communications regarding the credit quality of the portfolio).
to disclose ratings considered in those credit determinations, and the ratings would reflect that increased risk. As a result, the disclosure to investors of these risk indicators may have the effect of penalizing funds that assume more risk.

3. Alternatives

In considering how to meet our obligations under the Dodd-Frank Act with respect to Form N-MFP, we evaluated two primary alternatives. In 2011, we proposed to completely eliminate the following two form items: the item that requires a fund to identify whether a portfolio security is a first tier security, a second tier security, or an unrated security; and the item that requires the fund to identify the “requisite NRSROs” for each security (and for each demand feature, guarantee, or other credit enhancement). We are not re-proposing this alternative because we now believe that completely eliminating such disclosure requirements masks not only the credit ratings but also information on whether or not the fund uses credit ratings when making its investment decisions.

We also considered not removing the disclosure requirement as recommended by several commenters to the 2011 Proposing Release.235 We elected not to leave the current disclosure requirements as is, but instead to re-propose the required disclosure of NRSRO ratings only in certain circumstances. We believe this re-proposal would be in keeping with Congressional intent underlying section 939A of the Dodd-Frank Act to reduce perceived government endorsement of credit ratings.

4. Request for Comment

We request comment on our estimates and assumptions regarding the costs and benefits

\[^{235}\text{See BlackRock Comment Letter, supra note 122; Dreyfus Comment Letter, supra note 30; Federated Comment Letter, supra note 30; Comment Letter of the Securities Industry and Financial Markets Association (Apr. 18, 2011).}\]
of the re-proposed amendments to Form N-MFP and the effects of these amendments on efficiency, competition, or capital formation. As discussed above, we believe that most, if not all, money market funds will continue to consider NRSRO ratings in some form. We request comment on whether any funds expect that they will not report NRSRO ratings, and on shareholders’ and third parties’ likely response to funds that do not report NRSRO credit ratings. We also request comment on our assumption that the costs to money market funds to reprogram their Form N-MFP filing software, in order to comply with the re-proposed amendments, would be the same costs that we discuss in the Paperwork Reduction Act analysis of this release.236 Finally, we request comment on the costs and benefits of the alternatives to the re-proposed amendments discussed above.

For purposes of SBREFA, we also request information regarding the potential annual effect of the re-proposed amendments to Form N-MFP on the U.S. economy. Commenters are requested to provide empirical data to support their views.

C. Exclusion from the Issuer Diversification Requirement

1. Economic Baseline

As discussed above, most money market fund portfolio securities that are subject to a guarantee by a non-controlled person are currently subject to a 10 percent diversification requirement on guarantors but no diversification requirement on issuers, while non-government securities with guarantors that do not qualify as non-controlled persons are generally subject to both a 5 percent diversification requirement with respect to issuers and a 10 percent diversification requirement with respect to guarantors.237 Today, we adopted amendments to rule 236

See supra notes 180-187 and accompanying text.

237 We note that single state funds may invest up to 25% of fund assets in securities of any single
2a-7 that deem sponsors of asset-backed securities to be guarantors of the asset-backed security (unless the fund’s board rebuts the presumption). As a result, under rule 2a-7’s definition of a guarantee issued by a non-controlled person, both non-asset-backed securities and asset-backed securities subject to such a guarantee (including asset-backed securities with a presumed sponsor guarantee) are excluded from the rule’s issuer diversification requirement. That is, non-asset-backed securities and asset-backed securities subject to a guarantee by a non-controlled person are subject to a 10 percent diversification requirement on guarantors, but they are not subject to a 5 percent issuer diversification requirement on the issuer. This forms the economic baseline for the new diversification amendments that we are proposing today.

2. Economic Analysis

We believe that very few money market funds rely on the issuer diversification exclusion for securities subject to a guarantee by a non-controlled person. This belief is based on our analysis of February 2014 Form N-MFP data, which shows that only 8 out of 559 money market funds held securities with a guarantee by a non-controlled person that exceeded the 5 percent diversification requirement for issuers. We believe that these and only these funds in February 2014 relied on the exclusion from the 5 percent issuer diversification requirement with respect to issuers of securities that are subject to a guarantee issued by a non-controlled person. However, we recognize that changes in fund assets could mask which funds rely on this exclusion at acquisition: a fund might be above the 5 percent limit today solely due to a decline in fund assets after acquisition, and a fund might be below the 5 percent limit today solely due to an increase in issuer, and tax-exempt funds may have as much as 15% of the value of portfolio securities invested in securities subject to guarantees or demand features issued by a single provider that is a non-controlled person. Rule 2a-7(d)(3)(i)(B); 2a-7(d)(3)(iii)(B).

238 See rule 2a-7(a)(18) (definition of guarantee); rule 2a-7(a)19) (definition of guarantee issued by a non-controlled person); rule 2a7(d)(3)(i) (issuer diversification).
fund assets after acquisition. Whatever the cause, a money market fund that has invested more than 5 percent of its assets in an issuer of securities subject to a guarantee issued by a non-controlled person in reliance on the current exclusion under current rule 2a-7 would, when those investments mature, have to reinvest the proceeds over 5 percent elsewhere. Based on the February 2014 Form N-MFP filings, we believe that only a few funds would have to make changes to their portfolios to bring them into compliance with the proposed amendments. These changes may or may not require the funds to invest in alternative securities, and the alternative securities may or may not be inferior because they offer, for example, lower yields, lower liquidity, or lower credit quality. It appears that the proposed elimination of the exclusion would have affected only 8 funds in February 2014. Five of these 8 funds exceeded the 5 percent issuer concentration limit by less than 1 percent of fund assets, 2 of the 8 exceeded that limit by less than 2 percent, and the remaining fund exceeded the limit by slightly more than 5 percent. In most cases, the fund exceeded the 5 percent diversification requirement with respect to only one issuer (one fund exceeded the requirement by less than 1 percent with respect to two issuers, and two funds had greater than 5 percent exposure to the same issuer). Because of the less than significant impact on these funds, we believe that the potential lower yields, less liquidity or increased risks associated with the proposal would be small for the affected funds.240

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239 All of rule 2a-7’s diversification limits are applied at the time of acquisition. For example, a fund may not invest in a particular issuer if, after acquisition, the fund’s aggregate investments in the issuer would exceed 5% of fund assets. But if the fund’s aggregate exposure after making the investment was less than 5%, the fund would not be required to later sell the securities if the fund’s assets decreased and the fund’s investment in the issuer came to represent more than 5% of the fund’s assets.

240 Consider, for example, how reducing a position from 7% to 5% might affect fund yields. The effect could be as small as 0% if the 2% of assets are reinvested in securities that offer the same yield as the original 7% of assets. On the other hand, the portfolio change could decrease fund yields by as much as $2/7 \approx 29\%$ if all of the portfolio yield came from the 7% security. We believe that funds will choose alternative securities that have similar yields as the securities.
We assume that all funds would incur costs associated with updating their systems to reflect the proposed amendment, as well as the associated compliance costs, if their systems already incorporate this issuer diversification exclusion. We believe that these costs would be small for all funds because we believe that all funds currently have the ability to monitor issuer diversification to comply with rule 2a-7’s limits on issuer concentration.\(^{241}\)

Our proposed amendment offers two primary benefits. First, the amendment simplifies rule 2a-7’s diversification requirements by eliminating the exclusion for securities with a guarantee issued by a non-controlled person. This would lower certain compliance and operational costs to the extent that funds no longer have to keep track of the securities that have such guarantees and would be eligible for the exclusion. Second, by requiring greater issuer diversification for those funds that rely on the exclusion, the proposed amendments will reduce concentration risk in those funds and may make it easier for funds to maintain or generate liquidity during periods when they impose fees and/or gates.\(^{242}\) We estimate that 8 funds exceeded the 5 percent issuer diversification limit in February 2014; nevertheless, we recognize that these amendments may constrain more funds in the future that otherwise would have less issuer diversification.

Because we believe that the universe of potentially affected funds and issuers is small, we believe that our proposed amendments will have only negligible effects on efficiency, competition, and capital formation. Although we recognize that our proposed amendments may affect more funds and more issuers in the future, we estimate that they will affect only 8 funds replaced.

\(^{241}\) See 1991 Adopting Release, supra note 22, at section II.B.1 (adopting the issuer concentration limit).

\(^{242}\) See supra section II.C.
and 8 issuers today. These 8 funds exceed the proposed issuer diversification limit by only a small amount for the 8 issuers. We believe that the 8 funds will find comparable alternative securities for the amount that exceeds 5 percent, and we believe that the 8 issuers will find other investors willing to buy the amount that exceeds the 5 percent for a comparable price.

3. Alternatives

As an alternative to eliminating the exclusion from issuer diversification for securities with a guarantee issued by a non-controlled person, we considered requiring money market funds to be more diversified by lowering a fund’s permitted exposure to any guarantor or provider of a demand feature from 10 percent to 5 percent of total assets. We discussed potential benefits and costs of this alternative approach, and we requested comment on it in the 2013 Money Market Fund Proposing Release.\(^\text{243}\) As discussed in more detail above, we decided that the current requirements for diversification of guarantors and providers of demand features together with the issuer diversification requirement if applied generally to all securities, as under the proposed amendment, appropriately address our concerns relating to money market fund risk exposures.\(^\text{244}\) We also believe that the potential costs of this alternative approach would likely be more significant than the costs of our proposal. As of the end of February 2014, we estimate that 107 (of 229) prime money market funds had total exposure to a single entity (including directly issued, asset backed commercial paper sponsorship, and provision of guarantees and demand features) in excess of 5 percent. Under the alternative, any fund that had exposure to an entity

\(^{243}\) See 2013 Money Market Fund Proposing Release, supra note 5, at section III.J.4. We received no comments on this alternative approach. We also requested comment in 2009 on whether to reduce rule 2a-7’s current diversification limits. See 2009 Money Market Fund Proposing Release, supra note 127, at section II.D. Most commenters opposed these reforms because, among other reasons, the reductions could increase risks to funds by requiring the funds to invest in relatively lower quality securities. See id. at n.909.

\(^{244}\) See supra text following note 137 and accompanying notes 138-140.
greater than 5 percent when those assets matured would have to reinvest the proceeds of the securities creating that exposure in different securities or securities with a different guarantor. Those changes may or may not require those funds to invest in alternative securities, and those securities might present greater risk if they offered lower yields, lower liquidity, or lower credit quality. The alternative approach would appear to affect many more funds than would the proposed amendment. As a result, we believe that a better approach to achieving our reform goal would be to restrict risk exposures to all non-government issuers of securities subject to a guarantee or demand feature in the same way, and to require money market funds (other than tax-exempt and single state funds as described above) that invest in non-government securities subject to a guarantee to comply with the 5 percent issuer diversification requirement and the 10 percent diversification requirement on guarantors and demand feature providers.

4. Request for Comment

We request comment on our estimates and assumptions regarding the costs and benefits of the proposed amendments to rule 2a-7 that would remove the issuer diversification exclusion for securities subject to a guarantee by a non-controlled person, as well as the effects of this amendment on efficiency, competition, and capital formation. For purposes of SBREFA, we also request information regarding the potential annual effect of this proposed amendment to rule 2a-7 on the U.S. economy. Commenters are requested to provide empirical data to support their views.

In addition to our general request for comment on the costs and benefits of the proposed amendment, we request specific comment on certain aspects of the amendment. Are we correct in assuming that funds would not make substantial changes to their securities holdings as a result of the proposal? Do commenters expect that funds would incur operational costs in addition to,
or that differ from, the costs we outlined above? What would be the costs of making such changes? Do commenters expect that money market funds would encounter any difficulties in finding alternative investments under our proposal that have suitable characteristics? Why or why not? How would this proposal affect fund yields and the stability of fund NAVs and liquidity? Will any of these or other effects be large enough to affect the behavior of money market fund shareholders? How will shareholders respond? Would any of these effects be different in floating NAV funds than they would be in non-floating NAV funds? Would our proposed amendments have a differential effect on funds that impose fees and/or gates? Do commenters agree that our proposed amendments will have only negligible effects on issuers? Why or why not? Are there benefits or costs in any part of the money market fund industry that we have not identified or discussed? If so, what are those costs or benefits? Are we correct in our belief that there will be only negligible effects on efficiency, competition, and capital formation? If not, what are the effects that we overlooked?

VI. **REGULATORY FLEXIBILITY ACT CERTIFICATION**

Section 3(a) of the Regulatory Flexibility Act of 1980\(^{245}\) ("RFA") requires the Commission to undertake an initial regulatory flexibility analysis ("IRFA") of the proposed rule amendments on small entities unless the Commission certifies that the rule, if adopted, would not have a significant economic impact on a substantial number of small entities.\(^{246}\) Pursuant to 5 U.S.C. section 605(b), the Commission hereby certifies that the re-proposed and proposed amendments to rule 2a-7 under the Investment Company Act and the re-proposed amendments to Form N-MFP under the Investment Company Act would not, if adopted, have a significant economic impact.

\(^{245}\) 5 U.S.C. 603(a).

\(^{246}\) 5 U.S.C. 605(b).
economic impact on a substantial number of small entities.

We are re-proposing amendments to replace references to credit ratings in rule 2a-7 and modify disclosures of credit ratings in Form N-MFP. In addition, we are proposing to amend rule 2a-7’s provisions relating to issuer diversification to eliminate an exclusion from the current issuer diversification requirement for securities that are subject to a guarantee issued by a non-controlled person.

Based on information in filings submitted to the Commission, we believe that there are no money market funds that are small entities. For this reason, the Commission believes that the re-proposed and proposed amendments to rule 2a-7 and the re-proposed amendments to Form N-MFP would not, if adopted, have a significant economic impact on a substantial number of small entities.

We encourage written comments regarding this certification. We solicit comment as to whether the re-proposed and proposed amendments to rule 2a-7 and the re-proposed amendments to Form N-MFP could have an effect on small entities that has not been considered. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

**Statutory Authority**

The Commission is proposing amendments to rule 2a-7 under the authority set forth in sections 6(c) and 38(a) of the Investment Company Act [15 U.S.C. 80a-6(c), 80a-37(a)] and section 939A of the Dodd-Frank Act. The Commission is proposing amendments to Form

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247 Under the Investment Company Act, an investment company is considered a small business or small organization if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year. See 17 CFR 270.0–10.
N-MFP under the authority set forth in sections 8(b), 30(b), 31(a) and 38(a) of the Investment Company Act [15 U.S.C. 80a-8(b), 80a-29(b), 80a-30(a) and 80a-37(a)] and section 939A of the Dodd-Frank Act.

List of Subjects

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

TEXT OF RULE AND FORM AMENDMENTS

PART 270--RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 270 continues to read, in part, as follows:


* * * * * * *

2. Section 270.2a-7 is amended by:

a. In paragraph (a)(5), removing the words “and (D)”;

b. Removing paragraph (a)(11);

c. Redesignating paragraphs (a)(12) through (a)(13) as (a)(11) through (a)(12);

d. Revising newly designated paragraph (a)(11);

e. Removing paragraph (a)(14);

f. Redesignating paragraphs (a)(15) through (a)(22) as (a)(13) through (a)(19);

g. Revising newly designated paragraph (a)(17);

h. Removing paragraph (a)(22);

i. Redesignating paragraph (a)(23) as paragraph (a)(20);

j. Removing paragraph (a)(24);
k. Redesignating paragraph (a)(25) as paragraph (a)(21);

l. Removing paragraph (a)(26);

m. Redesignating paragraphs (a)(27) through (a)(31) as paragraphs (a)(22) through (a)(26);

n. Removing paragraph (a)(32);

o. Redesignating paragraphs (a)(33) and (a)(34) as paragraphs (a)(27) and (a)(28);

p. Revising paragraph (d)(2)(i);

q. Removing paragraph (d)(2)(ii);

r. Redesignating paragraphs (d)(2)(iii) and (d)(2)(iv) as paragraphs (d)(2)(ii) and (d)(2)(iii);

s. Revising newly designated paragraph (d)(2)(ii);

t. In newly designated paragraph (d)(2)(iii):

i. removing the words “or a first tier security” from the introductory text;

ii. removing the words “or first tier security, as the case may be” from paragraph (A);

u. Revising newly designated paragraph (d)(2)(iii)(C);

v. Adding paragraph (d)(2)(iii)(D);

w. In paragraph (d)(3):

i. Removing the words “and securities subject to a guarantee issued by a non-controlled person” in paragraph (d)(3)(i);

ii. Removing the words “first tier” in paragraph (d)(3)(i)(A)(I);

iii. Removing paragraph (d)(3)(i)(C);

iv. Removing paragraph (d)(3)(iii)(C);
x. In paragraph (f):
   i. Removing the word “Downgrades,” from the paragraph heading;
   ii. Removing paragraph (f)(1);
   iii. Redesignating paragraphs (f)(2) through (f)(4) as paragraphs (f)(1) through (f)(3);
   iv. Removing the words “and other events” in the heading of newly designated paragraph (f)(1);
   v. In the introductory text of newly designated paragraph (f)(1), removing the phrase “paragraphs (f)(2)(i) through (iii)” and adding in its place “paragraphs (f)(1)(i) through (iii)”;
   iv. Revising newly designated paragraph (f)(1)(ii);
   v. Removing newly designated paragraph (f)(1)(iii) and redesignating paragraph (f)(1)(iv) as paragraph (f)(1)(iii);
   y. Revising paragraph (g)(3);
   z. Revising paragraph (g)(8)(i)(B);
   aa. Revising paragraph (h)(3);
   bb. In paragraph (j):
      i. Removing the words “(a)(11)(i) (designation of NRSROs)” in the introductory text; and
      ii. Removing the phrase “in paragraph (d)(2)” and adding in its place the phrase “in paragraphs (d)(2) and (g)(3)” in paragraph (1).

The additions and revisions read as follows:

§ 270.2a-7 Money market funds.
(a) * * * * 

(11) Eligible security means a security:

(i) 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 include a finding that the security’s issuer has an exceptionally strong capacity to meet its short-term financial obligations;


(ii) That is issued by a registered investment company that is a money market fund; or

(iii) That is a government security.

* * * * * *

(17) Guarantee issued by a non-controlled person means a guarantee issued by a person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the guarantee (control means “control” as defined in section 2(a)(9) of the Act) (15 U.S.C. 80a-2(a)(9)).

* * * * *

(d) * * *

(2) * * *

(i) General. The money market fund shall limit its portfolio investments to those United States dollar-denominated securities that are at the time of acquisition eligible securities.

(ii) Securities subject to guarantees. A security that is subject to a guarantee may be determined to be an eligible security based solely on whether the guarantee is an eligible
security, *provided however*, that the issuer of the guarantee, or another institution, has undertaken to promptly notify the holder of the security in the event the guarantee is substituted with another guarantee (if such substitution is permissible under the terms of the guarantee).

(iii)  * * * *

(C) The fund’s board of directors determines that the issuer of the underlying security or any guarantor of such security has a very strong capacity for payment of its financial commitments; and

(D) The issuer of the conditional demand feature, or another institution, has undertaken to promptly notify the holder of the security in the event the conditional demand feature is substituted with another conditional demand feature (if such substitution is permissible under the terms of the conditional demand feature).

* * * * *

(f)  * * *

(1)  * * *

(ii) A portfolio security ceases to be an eligible security (*e.g.*, no longer presents minimal credit risks); or

* * * * * *

(g)  * * *

(3) *Ongoing review of credit risks*. The written procedures must require the adviser to provide ongoing review of whether each security (other than a government security) continues to present minimal credit risks. The review must:

(i) Include an assessment of each security’s credit quality, including the issuer’s capacity to meet its short-term financial obligations; and
(ii) Be based on, among other things, financial data of the issuer of the portfolio security or provider of the guarantee or demand feature, as the case may be, and in the case of a security subject to a conditional demand feature, the issuer of the security whose financial condition must be monitored under paragraph (e)(2)(iii) of this section, whether such data is publicly available or provided under the terms of the security’s governing documents.

* * * * * * * * *

(8) * * * *

(i) * * * *

(B) An event indicating or evidencing credit deterioration, such as a downgrade or default, of particular portfolio security positions, each representing various portions of the fund’s portfolio (with varying assumptions about the resulting loss in the value of the security), in combination with various levels of an increase in shareholder redemptions;

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(h) * * * *

(3) **Credit risk analysis.** For a period of not less than three years from the date that the credit risks of a portfolio security were most recently reviewed, a written record must be maintained and preserved in an easily accessible place of the determination that a portfolio security is an eligible security, including the determination that it 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.

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3. Section 12d3-1(d)(7)(v) is amended by removing the phrase “§§ 270.2a-7(a)(8)
and 270.2a-7(a)(15)” and adding in its place the phrase “§§ 270.2a-7(a)(9) and 270.2a-7(a)(16)”;

4. Section 31a-1(b)(1) is amended by removing the phrase “(as defined in § 270.2a-7(a)(8) or § 270.2a-7(a)(15) respectively)” and adding in its place the phrase “(as defined in § 270.2a-7(a)(9) or § 270.2a-7(a)(16) respectively)”.

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

5. The authority citation for Part 274 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, and 80a–29, unless otherwise noted.

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4. Form N-MFP (referenced in § 274.201) is amended by:

a. Revising Item C.9;

b. Revising Item C.10;

d. Removing Items C.14.b and C.14.c;


f. Adding new Item C.14.e;

g. Removing Items C.15.b and C.15.c;

h. Redesignating Item C.15.d as Item C.15.b;

i. Adding new Item C.15.c;


k. Redesignating Item C.16.e as Items C.16.c; and

l. Adding new Item C.16.d.
The revisions read as follows:

Note: The text of Form N-MFP does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM N-MFP

* * * * *

Item C.9 Is the security an Eligible Security? [Y/N]

Item C.10 Security rating(s) considered. Provide 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). If none, leave blank.

* * * * *

Item C.14 * * *

e. Rating(s) considered. Provide each rating assigned to the demand feature(s) or demand feature provider(s) 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 assigned to the demand feature(s) or demand feature provider(s) that the board of directors considered in evaluating the quality, maturity or liquidity of the security (together with the name of the assigning NRSRO). If none, leave blank.

* * * * *

Item C.15 * * *

c. Rating(s) considered. Provide each rating assigned to the guarantee(s) or guarantor(s) 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 assigned to the guarantee(s) or guarantor(s) that the board of directors considered in evaluating the quality, maturity or liquidity of the security (together with the name of the assigning NRSRO). If none, leave blank.

Item C.16 * * * *

d. Rating(s) considered. Provide each rating assigned to the enhancement(s) or enhancement provider(s) 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 assigned to the enhancement(s) or enhancement provider(s) that the board of directors considered in evaluating the quality, maturity or liquidity of the security (together with the name of the assigning NRSRO). If none, leave blank.

By the Commission.

Kevin M. O’Neill
Deputy Secretary

Dated: July 23, 2014