

SUPPORTING STATEMENT
Rule 2a-7

A. JUSTIFICATION

1. Necessity for the Collection Information

Money market funds are open-end management investment companies that differ from other open-end management investment companies in that they seek to maintain a stable price per share, usually \$1.00. Rule 2a-7 (17 CFR 270.2a-7) under the Investment Company Act of 1940 (15 U.S.C. 80a) (the “Act”) exempts money market funds from the valuation requirements of the Act, and, subject to certain risk-limiting conditions, permits money market funds to use the “amortized cost method” of asset valuation or the “penny-rounding method” of share pricing. It also imposes certain recordkeeping and reporting obligations on money market funds.

On June 30, 2009, the Commission issued a release proposing to amend rule 2a-7 in several respects.¹ Our proposal would amend the rule by: revising portfolio quality and maturity requirements; introducing liquidity requirements; requiring money market fund boards to adopt procedures providing for periodic stress testing of the fund’s portfolio; requiring funds to disclose monthly on their websites information on portfolio securities; and finally, requiring money market fund boards to determine, at least once each calendar year, that the fund has the capability to redeem and issue its securities at prices other than the fund’s stable net asset value per share. Three of the proposed amendments would create new collection of information requirements. The respondents to these collections of information would be money market funds or their advisers, as noted below.

First, the proposed amendments would require money market fund boards to adopt written procedures that provide for the periodic testing of the fund’s ability to maintain a stable

¹ See Money Market Fund Reform, Investment Company Act Release No. 28807 (June 30, 2009) (74 FR 32688 (July 8, 2009)).

net asset value per share based on certain hypothetical events.² These procedures also would have to provide for a report of the testing results to be submitted to the board of directors at its next regularly scheduled meeting, and an assessment by the fund's adviser of the fund's ability to withstand the events (and concurrent occurrences of those events) that are reasonably likely to occur within the following year.³ We anticipate that stress testing would give fund advisers a better understanding of the effect of potential market events and shareholder redemptions on their funds' ability to maintain a stable net asset value, the fund's exposure to that risk, and actions the adviser may need to take to mitigate the possibility of the fund breaking the buck.

Second, the proposed amendments would require money market funds to post monthly portfolio information on their websites.⁴ We believe that greater transparency of fund portfolios may allow investors to exert influence on risk-taking by fund advisers, and thus reduce the likelihood that a fund will break the buck.

Finally, we are proposing to amend rule 2a-7 to require a money market fund to promptly notify the Commission by electronic mail of the purchase of a money market fund's portfolio security by an affiliated person in reliance on Rule 17a-9 (17 CFR 270.17a-9) under the Act and to explain the reasons for such purchase.⁵ The proposed reporting requirement is designed to

² Proposed rule 2a-7(c)(8)(ii)(D). These events would include, but would not be limited to, a change in short-term interest rates, an increase in shareholder redemptions, a downgrade of or default on portfolio securities, and the widening or narrowing of spreads between yields on an appropriate benchmark the fund has selected for overnight interest rates and commercial paper and other types of securities held by the fund.

³ Proposed rule 2a-7(c)(8)(ii)(D)(2), (3). The report to the board would include the dates on which the testing was performed and the magnitude of each hypothetical event that would cause the deviation of the money market fund's net asset value calculated using available market quotations (or appropriate substitutes that reflect current market conditions) from its net asset value per share calculated using amortized cost to exceed ½ of 1 percent.

⁴ Proposed rule 2a-7(c)(12).

⁵ See proposed rule 2a-7(c)(7)(iii).

assist Commission staff in monitoring money market funds' affiliated transactions that otherwise would be prohibited.

2. Purpose of the Information Collection

The recordkeeping requirements in rule 2a-7 are designed to enable Commission staff in its examinations of money market funds to determine compliance with the rule, as well as to ensure that money market funds have established procedures for collecting the information necessary to make adequate credit reviews of securities in their portfolios. The reporting requirements of rule 2a-7, including the proposed new reporting requirement regarding rule 17a-9 transactions, are intended to assist Commission staff in overseeing money market funds. Requiring money market fund boards to adopt written stress testing procedures would give fund advisers a better understanding of the effect of potential market events and shareholder redemptions on their funds' ability to maintain a stable net asset value, the fund's exposure to that risk, and actions the adviser may need to take to mitigate the possibility of the fund breaking the buck. Requiring money market funds to post monthly portfolio information on their websites may allow investors to exert influence on risk-taking by fund advisers, and thus reduce the likelihood that a fund will break the buck.

3. Role of Improved Information Technology

In addition to electronic filing of information already required under rule 2a-7 as an exhibit to Form N-SAR, under the proposed amendments to rule 2a-7, money market funds would be required to post monthly portfolio information on their websites, taking advantage of investors' widespread use of the Internet to obtain investment information. Funds would also be required to notify the Commission of transactions conducted pursuant to rule 17a-9 via electronic mail, reflecting current primary methods of communications in the business world.

4. Efforts to Identify Duplication

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication, and reevaluates them whenever it proposes a rule or form, or a change in either. The recordkeeping, reporting, and website posting proposed to be required by rule 2a-7 are not duplicated elsewhere. Some of the money market fund portfolio information included in the new website posting requirement would duplicate certain information filed by money market funds on a less frequent basis on Form N-Q. The proposed amendments, however, would exempt money market funds from filing that duplicative information on Form N-Q.

5. Effect on Small Entities

As is the case for current rule 2a-7 reporting and recordkeeping requirements, the proposed new requirements under rule 2a-7 are the same for all money market funds, including those that are small entities. The portfolio website posting requirement involves organizing information that the funds already collect for current less frequent portfolio holdings reporting requirements and many money market funds already voluntarily post this information on their website on a more frequent basis. The stress testing need not be conducted in any particular manner—money market funds are free to determine what stress testing is most appropriate for them as long as it covers the general areas outlined in the Commission’s proposed rule amendment. The proposed reporting requirement of transactions conducted pursuant to rule 17a-9 should impose only minimal burdens on money market funds, including small funds, as discussed further below.

6. Consequences of Less Frequent Collection

As discussed above, the proposed amendments to rule 2a-7 would require money market fund boards to adopt written procedures that provide for the periodic testing of the fund's ability to maintain a stable net asset value per share based on certain hypothetical events, would require money market funds to post monthly portfolio information on their websites, and would require a money market fund to promptly notify the Commission by electronic mail of the purchase of a money market fund's portfolio security by an affiliated person in reliance on rule 17a-9 and to explain the reasons for such purchase.

We expect that money market fund boards will adopt stress testing procedures initially and then modify them periodically as necessary because of changing market conditions or the changing nature of the money market fund. Currently, money market funds are only required to disclose portfolio holdings quarterly, and even then may disclose information as old as 70 days prior to the filing. Most of this information is stale by the time it is disclosed. We are proposing to require that this information be posted on the fund's website within two business days of the end of each month. We believe that this frequency allows current and prospective investors in the fund to have timely information about the fund without excessively burdening money market funds. Many money market funds voluntarily provide this information on their websites even more frequently than monthly. Finally, the reporting of transactions conducted in reliance on rule 17a-9 will only be required in the relatively rare event that such a transaction is made.

7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)

Rule 2a-7 requires money market funds to retain certain written records for more than three years. The proposed amendments to rule 2a-7 would require money market funds to retain records of the reports to the board of directors on stress tests and the fund adviser's assessments for at least 6 years (the first two in an easily accessible place).⁶ The long-term retention of these

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Proposed rule 2a-7(c)(11)(vii).

records is necessary to allow Commission inspection staff to determine compliance with these aspects of rule 2a-7. The proposed amendments also would require funds to post portfolio information monthly. Given the short-term nature of money market fund portfolio holdings, this increased frequency of information collection is necessary to provide portfolio information that is meaningful to investors.

8. Consultation Outside the Agency

The Commission requested public comment on the collection requirements in the proposed amendments to rule 2a-7.

The Commission and the staff of the Division of Investment Management also participate in an ongoing dialogue with representatives of the investment company industry through public conferences, meetings and informal exchanges. These various forums provide the Commission and the staff with a means of ascertaining and acting upon paperwork burdens confronting the industry.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Not applicable.

11. Sensitive Questions

Not applicable.

12. Estimates of Hour Burden

OMB recently approved the collection of information renewal submission for rule 2a-7 with a burden of 310,983 hours per year. The additional burden hours associated with the proposed amendments to rule 2a-7 are discussed below.

a. Stress Testing

Commission staff believes that in light of the market events impacting money market funds last fall most, if not all, money market funds currently conduct some stress testing of their portfolios as a matter of routine fund management and business practice.⁷ These procedures likely vary depending on the fund's investments. For example, a prime money market fund that is offered to institutional investors may test for hypothetical events such as potential downgrades or defaults in portfolio securities while a U.S. Treasury money market fund may not. Some funds that currently conduct testing may be required to include additional hypothetical events under our proposed amendments. These funds likely provide regular reports of the test results to senior management. We expect, however, that most funds do not have written procedures documenting the stress testing, do not report the results of testing to their boards of directors, and do not provide an assessment from the fund's adviser regarding the fund's ability to withstand the hypothetical events reasonably likely to occur in the next year.

Commission staff believes that the stress testing procedures are or would be developed for all the money market funds in a fund complex by the fund adviser, and would address appropriate variations for individual money market funds within the complex. Staff estimates that it would take a fund adviser an average of 21 hours for a portfolio risk analyst initially to

⁷ The estimates of hour burdens and costs provided in the PRA and cost benefit analyses are based on staff discussions with representatives of money market funds and on the experience of Commission staff. We expect that the board of directors would be the same for all the money market funds in a complex, and thus could adopt the stress test procedures for all money market funds in the complex at the same meeting.

draft procedures documenting the complex's stress testing, and 3 hours for the board of directors to consider and adopt the written procedures. We estimate that 171 fund complexes with money market funds are subject to rule 2a-7. We therefore estimate that the total burden to draft these procedures initially would be 4104 hours.⁸ Amortized over a three-year period, this would result in an average annual burden of 8 hours for an individual fund complex and a total of 1368 hours for all fund complexes.⁹ We estimate that this burden would result in an aggregate cost to all money market funds of \$1,013,175 per year.¹⁰

Staff estimates that a risk analyst also may spend an average of 6 hours per year revising the written procedures to reflect changes in the type or nature of hypothetical events appropriate to stress tests and the board would spend 1 hour to consider and adopt the revisions, for a total annual burden of 1197 hours.¹¹ This burden would result in an estimated aggregate cost to all money market funds of \$966,150 per year.¹² Commission staff estimates further that it would take an average of 10 hours of portfolio management time to draft each report to the board of directors, 2 hours of an administrative assistant's time to compile and copy the report and 15 hours of the fund adviser's time to provide an assessment of the funds' ability to withstand

⁸ This estimate is based on the following calculation: (21 hours + 3 hours) x 171 fund complexes = 4104 hours.

⁹ These estimates are based on the following calculations: (21 + 3) ÷ 3 = 8 hours; 8 x 171 fund complexes = 1368 hours. PRA submissions for approval are made every three years. To estimate an annual burden for a collection of information that occurs one time, the total burden is amortized over the three year period.

¹⁰ This estimate is based on the following calculation: 21 hours to draft policies and procedures x \$275/hour for a risk management specialist = \$5,775. 3 hours to adopt the policies and procedures x \$4000/hour for board of directors action = \$12,000. (\$5,775 + \$12,000) x 171 fund complexes = \$3,039,525 for 3 years or \$1,013,175 per year.

¹¹ This estimate is based on the following calculation: (6 hours (analyst) + 1 hour (board)) x 171 fund complexes = 1197 hours.

¹² This estimate is based on the following calculation: 6 hours to revise policies and procedures x \$275/hour for a portfolio risk analyst = \$1,650. 1 hour to adopt the revised policies and procedures x \$4000/hour for board of directors action = \$4,000. (\$1,650 + \$4,000) x 171 fund complexes = \$966,150 per year.

reasonably likely hypothetical events in the coming year. The report must be provided at the next scheduled board meeting, and we estimate that the report would cover all money market funds in a complex. We also believe that the fund adviser would provide an assessment each time it provided a report. Finally, we assume that funds would conduct stress tests no less than monthly. With an average of 6 board meetings each year, we estimate that the annual burden would be 162 hours for an individual fund complex with a total annual burden for all fund complexes of 27,702 hours.¹³ This burden would result in an estimated aggregate cost to all money market funds of \$7,180,074 per year.¹⁴

The proposed amendment would require the fund to retain records of the reports on stress tests and the assessments for at least 6 years (the first two in an easily accessible place).¹⁵ The retention of these records would be necessary to allow the staff during examinations of funds to determine whether a fund is in compliance with the stress test requirements. The Commission staff estimates that the burden would be 10 minutes per fund complex per meeting to retain these records for a total annual burden of 171 hours for all fund complexes.¹⁶ This burden would result in an aggregate cost to all money market funds of \$10,609 per year.¹⁷

¹³ These estimates are based on the following calculations: (10 hours + 2 hours + 15 hours) x 6 meetings = 162 hours; 162 hours x 171 fund complexes = 27,702 hours.

¹⁴ This estimate is based on the following calculation: 10 hours to draft report to board x \$275/hour for a senior portfolio risk analyst = \$2,750. 2 hours to compile and copy the report x \$62/hour for an administrative assistant = \$124. 15 hours for adviser assessment x \$275/hour for a senior portfolio risk manager = \$4,125. The cost of each report is thus \$2,750 + \$124 + \$4,125 = \$6,999, and the annual cost of this reporting is \$6,999/report x 6 reports per year = \$41,994. \$41,994 x 171 fund complexes = \$7,180,974 per year.

¹⁵ Proposed rule 2a-7(c)(11)(vii).

¹⁶ This estimate is based on the following calculation: 0.1667 hours x 6 meetings x 171 fund complexes = 171 hours.

¹⁷ This estimate is based on the following calculation: 0.1667 hours to retain records x \$62/hour for an administrative assistant = \$10.34. \$10.34 x 6 reports/year = \$62.04. \$62.04 x 171 fund complexes = \$10,609 per year.

Thus, we estimate that for the three years following adoption, the average annual burden resulting from the stress testing requirements would be 178 hours for each fund complex with a total of 30,438 hours for all fund complexes.¹⁸ This burden would result in an annual cost burden for all fund complexes of \$9,170,908.¹⁹

b. Public Website Posting

The proposed amendments would require money market funds to post monthly portfolio information on their websites.²⁰ We estimate that there are approximately 750 money market funds that would be affected by this proposal. We understand, based on interviews with industry representatives, that most money market funds already post portfolio information on their webpages at least quarterly.²¹ To be conservative, the staff estimates that 20 percent of money market funds, or 150 funds, do not currently post this information at least quarterly, and therefore would need to develop a webpage to comply with the proposed rule. Commission staff estimates that a money market fund would spend approximately 24 hours of internal money market fund staff time initially to develop the webpage. Staff further estimates that a money market fund would spend approximately 4 hours of professional time to maintain and update the relevant webpage with the required information on a monthly basis. Based on an estimate of 750 money

¹⁸ These estimates are based on the following calculations: 8 hours (draft procedures) + 7 hours (revise procedures) + 72 hours (6 reports) + 90 hours (assessments) + 1 hour (record retention) = 178 hours; 1368 hours (draft procedures) + 1197 hours (revise procedures) + 12,312 hours (6 reports) + 15,390 (6 assessments) + 171 hours (record retention) = 30,438 hours.

¹⁹ Based on the following calculation: \$1,013,175 (for creation of policies and procedures) + \$966,150 (for revising policies and procedures) + \$7,180,074 (for board reporting) + \$10,609 (for recordkeeping) = \$9,170,908.

²⁰ Proposed rule 2a-7(c)(12).

²¹ Certain of the required information is currently maintained by money market funds for regulatory reasons, such as in connection with accounting, tax and disclosure requirements. We understand that the remaining information is retained by funds in the ordinary course of business. Accordingly, for the purposes of our analysis, we do not ascribe any time to producing the required information.

market funds posting their portfolio holdings on their webpages, including 150 funds incurring start-up costs to develop a webpage, we estimate that, in the aggregate, the proposed amendment would result in a total of 37,200 average burden hours for all money market funds for each of the first three years.²² This burden would result in an estimated initial cost of \$741,600²³ for money market funds and an annual cost for all money market funds of \$7.4 million²⁴ to maintain and update this website disclosure.

c. Reporting of Rule 17a-9 Transactions

We are proposing to amend rule 2a-7 to require a money market fund to promptly notify the Commission by electronic mail of the purchase of a money market fund's portfolio security by an affiliated person in reliance on rule 17a-9 and to explain the reasons for such purchase.²⁵ We estimate that fund complexes will provide one notice for all money market funds in a particular fund complex holding a distressed security purchased in a transaction under rule 17a-9. As noted above, Commission staff estimates that there are 171 fund complexes with money market funds subject to rule 2a-7. Of these fund complexes, Commission staff estimates that an average of 25 per year would be required to provide notice to the Commission of a rule 17a-9

²² The estimate is based on the following calculations. The staff estimates that 150 funds would require a total of 3600 hours initially to develop a webpage (150 funds x 24 hours per fund = 3600 hours). In addition, each of the 750 funds would require 48 hours per year to update and maintain the webpage, for a total of 36,000 hours per year (4 hours per month x 12 months = 48 hours per year; 48 hours per year x 750 funds = 36,000). The average annual hour burden for each of the first three years would thus equal 37,200 hours $((3600 + (36,000 \times 3)) \div 3)$.

²³ This estimate is based on the following calculations. We estimate that a webmaster at a money market fund would initially develop and maintain the webpage at a cost of \$206 per hour. 24 hours to initially develop the webpage x \$206 per hour = \$4944. 4 hours to maintain and update the webpage x \$206 per hour = \$9888. \$4944 x 150 portfolios creating a new webpage = \$741,600.

²⁴ This estimate is based on the following calculations. 4 hours for a webmaster to maintain and update the webpage x \$206 per hour = \$9888. \$9888 x 750 money market fund portfolios = \$7,416,000.

²⁵ See proposed rule 2a-7(c)(7)(iii).

transaction, with the total annual response per fund complex, on average, requiring 1 hour of an in-house attorney's time. Given these estimates, the total annual burden of this proposed amendment to rule 2a-7 for all money market funds would be approximately 25 hours.²⁶ This burden would result in an annual cost burden for all fund complexes of \$7625.²⁷

All of the estimates in this section are made solely for the purposes of the PRA and are not derived from a comprehensive or even representative survey or study of the cost of Commission rules. We estimate that the additional burden hours associated with the proposed amendments to rule 2a-7 would increase the burden to 378,646 hours annually.²⁸

13. Estimate of Total Annual Cost Burden

As part of the renewal submission for rule 2a-7 that OMB approved, the Commission estimated that in addition to the costs discussed in section 12, money market funds will incur other costs to preserve records, as required under rule 2a-7. These costs estimates were \$72.4 million per year to preserve records and up to \$48.8 million for funds that establish computer systems for preserving records. Commission staff also estimated that absent the current rule 2a-7 requirements, money market funds would spend at least half of the amount for capital costs (\$24.4 million) and for record preservation (\$36.2 million) to establish and maintain these records and the systems for preserving them as a part of sound business practices to ensure

²⁶ The estimate is based on the following calculation: (25 fund complexes x 1 hour) = 25 hours.

²⁷ This estimate is based on the following calculation: 25 hours x \$305 = \$7625. Data from the Securities Industry and Financial Markets Association's Report on Management & Professional Earnings in the Securities Industry 2008, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for an attorney is \$305 per hour.

²⁸ The 378,646 hour annual burden estimate is based on the following burden estimates: 310,983 hours (current hour burden estimate) + 30,438 hours (stress testing) + 37,200 hours (public website posting) + 25 hours (reporting of rule 17a-9 transactions).

diversification and minimal credit risk in a portfolio for a fund that seeks to maintain a stable price per share.

Commission staff estimates that the proposed amendments to rule 2a-7 would not result in any costs other than those described in section 12 for the estimated burden hours associated with the proposed amendments. Thus, the estimates of costs other than those discussed in section 12 remain the same.

14. Estimate of Cost to the Federal Government

Rule 2a-7 does not impose any costs on the federal government.

15. Explanation of Changes in Burden

Under the proposed amendments to rule 2a-7, the estimated total annual burden would increase from 310,983 to 378,646 hours. This increase is primarily attributable to the proposed stress testing and monthly website posting requirements. The estimated total annual cost, in addition to those discussed in section 12, would not increase as a result of the amendments.

16. Information Collection Planned for Statistical Purposes

Not applicable.

17. Approval to not Display Expiration Date

Not applicable.

18. Exceptions to Certification Statement

Not applicable.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.